

**PROPOSED INSTRUCTIONS TO INCOME,
PROFIT, VALUE ADDED AND SOCIAL
TAX ARTICLES OF THE
TAX CODE OF GEORGIA**

**GEORGIA
DECEMBER 15, 2001**

Forward from the Chairman

The Tax Department of the Tax Revenue Ministry of Georgia is committed to providing the public with information that will promote a greater understanding of the tax system of Georgia. The *Proposed Instructions to Income, Profit, Value Added and Social Taxes* will advance our efforts in this area by providing clearer instructions to specific articles in the Tax Code.

Tax instructions serve to clarify articles in the Tax Code and are an important part of an effective tax system. Without useful instructions individuals in government and in private practice often must resort to litigation to determine the intent and application of a particular Tax Code article. Often instructions simply repeat the language used in the Tax Code, thereby failing to provide needed clarification of Tax Code articles.

The *Proposed Instructions*, through explanation and/or examples, clarify the language used in the Tax Code. In addition, the *Proposed Instructions* employ a new numbering system that makes it easier to find the corresponding article in the Tax Code. Although the *Proposed Instructions* do not cover every article of the Tax Code they serve as a foundation on which additional instructions can be added in the future.

In order to become law the *Proposed Instructions* must be approved by the Ministry of Justice. Until such approval the *Proposed Instructions* are not law and may not be cited as legal authority. Even when approved, at no time can the instructions supercede the Tax Code and other legislative acts.

Employees of the Tax Department and other government agencies participated in the review and drafting of the *Proposed Instructions*. While the *Proposed Instructions* provide an indication of how these tax experts interpret articles in the Tax Code, at the present time the *Proposed Instructions* cannot be cited as the official position of the Tax Department or of other government agencies.

I wish to thank all of the individuals from government agencies and private practice who contributed to the drafting of the *Proposed Instructions*. In addition, I wish to express my appreciation to the United States Agency for International Development (USAID) and its contractor, KPMG Consulting Barents Group, for drafting, editing and publishing the *Proposed Instructions*.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Levan Chrdileli', is positioned to the left of a vertical line.

Levan Chrdileli
Chairman
Tax Department of the Tax Revenue Ministry of Georgia

Forward from the Editor

Tax instructions are a critical component of an effective tax system. Their primary function is to clarify articles in the Tax Code. Clarification can be accomplished through explanations of concepts, terms and procedures provided in legislation. Practical examples may be used in conjunction with explanations. Reviews of legislative history of tax laws also can be used to shed light on the intent of legislative drafters. Comprehensive, clear instructions serve both taxpayers and the Tax Department by reducing ambiguities in the tax laws that may reduce tax compliance. Without relevant, understandable instructions to provide guidance even the most well-intentioned tax laws may be misapplied, misinterpreted or avoided, resulting in lower levels of compliance, unnecessary tax disputes and, in the end, a loss of tax revenues.

As part of its ongoing efforts to improve tax administration and the effectiveness of tax laws KPMG Consulting Barents Group, under contract with the United States Agency for International Development (USAID), undertook to improve the effectiveness and usefulness of the current tax instructions. A review of existing instructions was conducted to analyze strengths and weaknesses of the current instructions. This review covered the following areas of the Tax Code: income, profit value added and social taxes. These taxes were selected based on revenues generated and impact on taxpayers. In addition, a limited number of general and administrative articles pertaining to these taxes were also reviewed.

The review uncovered the following weaknesses in the existing instructions.

1. A substantial portion of instructions in each of the areas reviewed simply repeats the language contained in the Tax Code. The disadvantages resulting from using instructions in this manner are significant.
 - The instructions fail to fulfill their primary purpose, which is to clarify statutory language.
 - Conflicts between the Tax Code and instructions result when amendments to instructions are not made simultaneously with amendments to corresponding articles in the Tax Code.
2. The numbers assigned to instruction articles do not match corresponding articles in the Tax Code. The absence of a simple, well-referenced numbering system makes it more difficult to locate instructions that correspond to Tax Code articles.

Each of the above deficiencies is addressed and remedied in the attached instructions.

1. Each instruction provides explanatory text and/or examples to explain the concept and language used in the corresponding Tax Code article. Language used in the instructions is not (with limited exceptions) repeated in the Tax Code. If the language in the Tax Code article is deemed to be sufficient and no further guidance is needed the instructions article states, "Refer to Tax Code". This system allows instructions to be added as deemed necessary and when amendments are made to the Tax Code.

2. Instruction articles are numbered according to their corresponding Tax Code article. A number ('1.' through '15.') is inserted before the instruction article to designate it as an instruction. The number inserted before the article number corresponds to the Part of the Tax Code where the article is located. For example, article 2.35 (Taxpayers) of the instructions corresponds to article 35 (Taxpayers) of the Tax Code, which is found in Part 2 (Income and Profit Taxes) of the Tax Code. This matching numbering system generally applies to subarticles as well.

The instructions do not include tax forms and guidance on how to complete them. While forms and guidance on how to complete them are necessary, our recommendation at this time is to include them in separate documents that are not part of the instructions.

It must be stressed that these instructions attempt to clarify, but not change, the existing tax laws. The process of drafting explanatory instructions revealed many inconsistencies or deficiencies in the underlying tax laws. However, any amendments to the Tax Code must be made according to existing legislative procedures. It is intended that the instructions will be reviewed annually, at which time new instructions can be added and existing instructions can be modified to reflect changes to the Tax Code.

These instructions were discussed and reviewed by a workgroup comprised of attorneys and accountants in private practice and representatives from the Tax Revenue Ministry and the Tax Department. We wish to express our appreciation to the individuals who participated in this workgroup, as well as to all individuals who submitted comments on the draft instructions.

These instructions cannot be cited as legal authority until they are approved and adopted by the Ministry of Justice. Until then they may only be proffered to indicate the views of the drafters of the instructions.

Note: These instruction are based on tax laws in effect on December 15, 2001.



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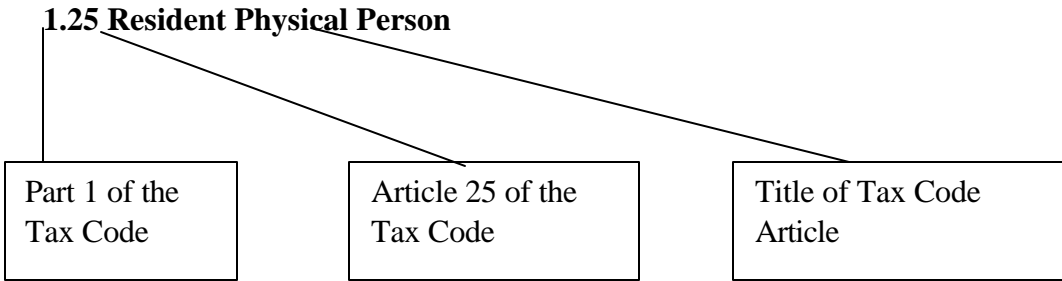
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Instruction Number Format

Each article in the instructions is numbered according to its corresponding Tax Code article.

The prefix to the instruction article numbers refers to the ‘Part’ of the Georgian Tax Code where the corresponding article is located.

Example



Instruction articles are organized under chapter titles as used in the Tax Code.

Unless mentioned otherwise, all references to specific articles in these instructions refer to articles contained in the Tax Code of Georgia.

PART 1. GENERAL PROVISIONS

Selected articles of the Tax Code that pertain to subsequent income, profit, VAT and are social tax articles are provided in this Part of the instructions.

Chapter 2. Definitions of Concepts and Terms Used in the Tax Code

1.7 Economic Activity

1. An “economic activity” includes any activity undertaken with the intent to earn profits, income, or compensation, regardless of the results of such activity. Unless specifically excluded in subarticle 2 any activity that is undertaken with the requisite intent is considered an economic activity even if it fails to earn profit, income or compensation. Economic activities can include legitimate as well as illegitimate activities. As a result, profits from illegitimate activities are also subject to tax.

For purposes of this article, the term “compensation” is defined as money or money equivalents received for the performance of economic activities or satisfaction of claims, but excluding that received though gift or inheritance.

Example 1

Georgian firm RRR manufactures and sells televisions. RRR conducts these activities with the intent to make a profit. In year 2000 RRR’s expenses exceeded its income. Even though RRR did not earn a profit in 2000 it will be considered to be engaged in an economic activity because it undertook its activities with the intent to earn a profit.

Example 2

Firm AFD provides loans to small businesses in Georgia at below market rates. AFD does not engage in these activities with the intent to earn a profit. However, it does engage in the activities with the intent to earn income. Unless AFD’s activities are excluded under article 7(2), AFD will be considered to be engaged in an economic activity because it possesses an intent to earn income, regardless of whether or not it does earn income.

2. Refer to the Tax Code for a description of activities that are not considered economic activities.
3. Economic activity can be classified as entrepreneurial or non-entrepreneurial. (See article 8.)

1.8 Entrepreneurial and Non-entrepreneurial Activity

1. Entrepreneurial activity is based on Article 1.1 of the Law on Entrepreneurs, which provides that any “legitimate and repeated activity carried out independently and in an organized manner to gain profit” is considered an entrepreneurial activity.

A physical person who engages in an entrepreneurial activity in violation of established procedures for registration and receipt of a license, certificate, or any other required document is for tax purposes considered to be an entrepreneur engaged in an entrepreneurial activity. (See article 26(2).) Per article 218(4), if an activity itself is not legitimate it also will be considered to be an entrepreneurial activity if it is repeated and carried out independently and in an organized manner to gain profit.

Example

Nino engages in an illegitimate gambling activity. She carries out the activity repeatedly, and independently, and in an organized manner with the intent to gain profit. Nino’s gambling activity is considered an entrepreneurial activity. Nino is subject to tax on any income he earns from this activity.

2. Refer to the Tax Code for a definition of non-entrepreneurial activity.
3. Refer to the Tax Code for types of non-entrepreneurial activities.
4. Refer to Tax Code.

1.9 Employment

1. The Tax Code provides that an employment relationship can arise in three ways.
 - a. Fulfillment of obligations by a physical person within the framework of relations regulated by labor legislation (Labor Code of Georgia) or legislation related to the state service. If the fulfillment of obligations is regulated by the Civil Code of Georgia (see article 629 of the Civil Code) an employment relationship does not arise and the worker is considered an independent contractor.
 - 1) For relations to be considered employment under the Labor Code and the Law on Public Service the physical person must:
 1. receive annual paid leave and sick leave;
 2. entitled to receive maternity and child care leave (females only);
 3. be subject to rules of conduct for violations for which the employer can impose disciplinary sanctions such as a warning, reprimand, demotion, or dismissal from the position.
 - 2) Generally, an employment relationship occurs when a person (employee) performs a service for a company, organization, or state body (employer) under an express or implied, written or verbal contract. In such relationship the employer provides the employee with appropriate resources and working conditions, directs and controls employee's work in all material details of his/her work and provides salary for employee's services according to the employment contract. (Additional factors are listed below.) An employee should perform terms stipulated by the employment contract pursuant to his/her qualifications, office position and duties, and comply with lawful instructions and policies of the employer.

In cases that do not fall clearly within the Labor Code or Civil Code the following factors are to be applied to determine if the employer has the right to control the employee's work, regardless of whether the right is exercised. Affirmative answers indicate that the employer has such a right and that an employment relationship exists. No one factor is dispositive.

EMPLOYMENT FACTORS	Y E S	N O
1. Does the worker receive instructions about where, when and how to perform work?		
2. Does the worker receive specific training?		
3. Must services be rendered personally by the worker?		
4. Does the employer hire the worker's assistants?		
5. Is the worker subject to set working hours?		
6. Is a full-time work commitment required?		
7. Is the work performed on the employer's premises?		
8. Is the work performed according to a set sequence of tasks?		
9. Must the worker submit regular reports concerning work progress?		
10. Are payments based on time worked rather than on completion of the job?		
11. Does the employer pay the worker's expenses?		
12. Does the employer supply the worker with tools and materials?		
13. Does the worker have little or no investment at stake?		
14. Is the worker protected against loss?		
15. Does the worker have only one "client" or "customer"?		
16. Does the worker forgo offering services to the public?		
17. Does the employer have a right to dismiss the worker?		

Example

Firm SDS and David, a trial attorney, entered into a verbal agreement whereby David would receive 26000 GEL at the end of the 2000 calendar year for representing SDS in two lawsuits. David works from home and has a number of other clients in addition to SDS. David decides all issue of strategy in his lawsuits, and he has independent technical resources (such as computer, legal library and database) to use in representing SDS. David does not receive from SDS any employee benefits or annual leave, and is not required to follow the rules of conduct introduced by SDS for its employees. Therefore David is not an employee, but merely performs services for SDS. David should register with the tax authorities and submit an income tax for year 2000 according to the article 87. Additionally David should submit an application for VAT registration according to article 92(1).

- b. Fulfillment of obligations by a physical person directly related to service in the armed forces, law enforcement or equivalent agencies, without reference to 1a above.
- c. Performing work while in the position of managing director of enterprises and organizations.

1.10 Charitable Activity

1. The Tax Code defines *charitable activity* as:

- a. direct financial support, including grants or any other assistance (support) to physical persons in need of this assistance (as determined by a competent agency) and;
- b. direct financial support to organizations (defined in article 19), including charitable organizations as well as educational and research activity performed by an organization in the public interest, unless otherwise precluded by this article.

Charitable activities may include:

- contributions, such as financial assistance, grant, support through goods or various services;
- contributions aimed at the general public use by the community as a whole or its indefinite portion thereof (such as activities listed in Article 10.2 of the Code), except political and other activities aimed at elections; and
- contributions by any natural or legal person to an organization (defined in article 19) or natural person, except those contributions where the parties are *related persons* as defined by article 24 of the Code.

Contributions should not provide an obligation on part of beneficiary towards the donor except the obligation to use the contribution as intended.

A distinction should be made between a charitable activity and a gift described in Chapter 27 of the Tax Code. A gift is any asset given by any natural person to any person, including related persons, for any legitimate purpose. A gift is usually a one-time contribution and may be revoked by reason of ingratitude of the beneficiary (Article 529 of the Civil Code) or in the event of hardship of donor (Article 530 of the Civil Code). Thus, unlike charitable contributions, the personality of the donors is limited to the natural persons, but the beneficiaries are not limited and could be any legal or physical person, related or unrelated to the donor. In case of the gift the transfer is made entirely gratuitously, without any obligation from the part of the beneficiary. The requirement to use the property transferred for the certain purpose may effect the qualification of the transfer as a gift.

Organizations that conduct a charitable activity receive the following benefits:

- article 47(b) exempts charitable organizations from profit tax, except profit earned from economic activities;
- article 101(x) exempts the import of goods for charitable purposes from VAT;
- article 166(d) exempts charitable organizations from Tax on Transfer of Immovable Property if such transfer is free of charge; and
- article 180 exempts Charitable Organizations from the Tax on Transfer of Motor Vehicles.

2. Refer to Tax Code for types of assistance provided by charitable activities.

3. Refer to the Tax Code for types of activities that are not considered charitable activities.

1.11 Religious Activity

1. Refer to Tax Code for definition of religious activity.
Many (but not all) goods, works, and services connected to religious activities are exempt from VAT. Refer to article 101.
2. Refer to Tax Code for definition of activities regarded as equivalent to religious activities.

1.12 Enterprises

1. Refer to the Tax Code for a definition of an enterprise.
2. Refer to Tax Code.

While an individual enterprise is not considered to be an enterprise for tax purposes, any physical person-entrepreneur who carries out an economic activity that meets the requirements of registration for VAT must be registered and account for VAT on that activity.

1.13 Georgian Enterprise and Foreign Enterprise

1. An enterprise is deemed to be a *Georgian enterprise* if:
 - a. it carries out its activities in Georgia (see articles 14 and 15); or
 - b. its management duties are performed in Georgia (see article 16).
2. A *foreign enterprise* is any enterprise that does not qualify as a Georgian enterprise pursuant to this article.

Example

ABC Corporation is registered in a foreign (outside Georgia) jurisdiction. Its shareholders and directors meet for regular meetings abroad, and the company maintains its principal office and majority of its books of account in a foreign country. The company purchases agricultural goods in Georgia and exports these goods to various countries. Under article 13 ABC Corporation is considered a foreign enterprise.

1.16 The Place of Management of an Enterprise

In determining the place of management of an enterprise, the place where:

1. the enterprise's principal office is located;
2. the director or owner's meeting are held;
3. the enterprise's books and records are maintained;
4. managerial functions are performed; and
5. any additional factors deemed relevant

should be considered.

1.17 Permanent Establishment

1. A "permanent establishment" of a foreign physical person or enterprise in Georgia means a fixed place through which economic activities of the person or enterprise are wholly or partially carried out (including activities performed by authorized persons described in (1)(c) below), excluding places described in subarticle 3 below.
 - a. A permanent establishment begins to exist as soon as the foreign physical person or enterprise (or authorized person) begins to conduct economic activities through a fixed place.
 - b. Permanent establishments include but are not limited to:
 - a place of management;
 - an office or branch; and
 - a factory or workshop.
 - c. Subject to 1(d) below, where an authorized person acting on behalf of a foreign physical person or enterprise has the authority to enter into contracts and frequently does enter into contracts on behalf of the foreign physical person or enterprise, that foreign physical person or enterprise shall be deemed to have a permanent establishment in Georgia with respect to activities undertaken by the authorized person.
 - d. A foreign physical person or enterprise shall not be considered to have a permanent establishment in Georgia merely because it carries on economic activities in Georgia through a broker, attorney or independent agent, provided such broker, attorney or agent is acting within his/her ordinary course of business.
 - e. A permanent establishment is required to apply for a Taxpayer Identification Number (TIN) under the procedures set forth in article 219.
 - f. Refer to article 92(3) for mandatory VAT registration requirements for permanent establishments.

2. The following are equivalent to a permanent establishment defined in subarticle 1(a):
 - a. a construction, assembly or erection site (including sites where related control activities are carried out);
 - b. equipment or structure, drilling equipment or ship used for the survey of natural resources (including establishments where related control activities are carried out);
 - c. a permanent base where a non-resident physical person carries out entrepreneurial activity.

Article 273(34) provides that this subarticle does not apply to the works and services performed by non-resident subcontractors carrying out gas and oil transactions according to law of Georgia on Oil and Gas.

3. Notwithstanding subarticles 1 and 2 above, certain establishment are not considered to be permanent establishment. Refer to the Tax Code for a list of establishments that are not considered to be permanent establishments.

1.18 Individual Enterprise

1. An “individual enterprise” is an enterprise, as defined in article 12, that:
 - a. is owned and managed by only one physical person (subject to exceptions in subarticle 2); and
 - b. is not a legal person.
2. In addition to individual enterprises defined in subarticle 1, individual enterprises also include the following, provided a legal person has not been formed:
 - a. enterprise in which the sole participants are family members, regardless of whether they manage the enterprise jointly or only one of them manages by joint consent;
 - b. farms established according to legislation where the sole owner is an individual or members of his family.
3. Income earned by individual enterprises is taxed to the physical person owner as income under Chapter 4 of the Tax Code rather than as profit under Chapter 5 of the Tax Code.
4. See article 15 for rules used in determining the place of activity of an individual enterprise.

1.23 Tax Agent

Refer to the Tax Code for a description of who is considered to be a tax agent, along with their rights and obligations.

Refer to instruction article 108 for information concerning tax agents in respect to a VAT “reverse charge”.

1.25 Resident Physical Persons

1. A physical persons is considered a resident if the person was on the territory of Georgia for more than 182 days during any 12-month period ending in a tax year or were employed abroad in the Georgian state service.
 - a. The residency test is applied on December 31 of each tax year. The status of resident or non-resident for the entire tax year is established on the last day of each tax year.
 - b. Any days a person spends in Georgia due to one of the items listed in article 25(2) are not considered as days in Georgia in determining status under the 182-day rule.
 - c. Any days a Georgian citizen spends outside the territory of Georgia while working for the Georgian state service are considered as days in Georgia in determining status under the 182 day rule.
2. For purposes of the residency a test a person will not be considered on the territory of Georgia if:
 - a. he/she has diplomatic status, or is a member of the family of such a person;
 - b. he/she is a staff member of an international organization or in the Civil Service of a foreign country, and/or a family member of such a person, except citizens of Georgia; or
 - c. he/she is on the territory of Georgia solely for transit purposes.
3. Subject to exceptions provided in subarticle 2 above, a day of location in Georgia is considered any part of a day during which a physical person was actually located on the territory of Georgia.
 - a) When arriving in Georgia by air a day is determined based on the time the aircraft first lands in the territory of Georgia. When departing Georgia by air a day is determined based on the time the aircraft departs the territory of Georgia.
 - b) When arriving in Georgia by land or sea a day is determined based on the time the person first enters the Georgian territory. When departing Georgia by land or sea a day is determined based on the time the individual departs the territory of Georgia.
 - c) Delays in arriving or departing the territory of Georgia due to inclement weather, illness or other events outside the person's control do not impact the physical presence rules defined in the subarticle.

Example

Sam, a physical person, arrived on the territory of Georgia by train on March 25, 1998. The train entered Georgia at 8 a.m. Sam departed Tbilisi by plane on April 26, 1998. The plane, destined for Vienna, departed Tbilisi airport at 11:40 p.m. Due to bad weather conditions the plane was forced to land in Batumi at

0:10 a.m. on March 27, 1998. The plane departed Batumi at 3 a.m. on March 27. Sam is considered to have been in Georgia for 33 days.

4. Refer to Tax Code.
5. The taxpayer is responsible for providing his/her correct status, including any changes in status, to any physical or legal person that hires him/her.

Example 1

Maria, a resident of a foreign country arrived in Georgia on September 1, 1998 and signed a 2-year employment contract on this date. The days she was physically present in Georgia in 1998 will used to determine her resident status. The date of her arrival on the territory of Georgia will be used regardless of the date she began working in Georgia. On December 31, 1998 Maria will determine her resident status for 1998 as follows.

<u>Month</u>	<u>Days in Georgia</u>
September	30
October	31
November	30
December	<u>31</u>
Total days in Georgia in 1998	122

Assuming Maria does not qualify for any exceptions provided in article 25(2), she will be considered a non-resident for all of 1998 because she was in Georgia less than 182 days in 1998.

Assume Maria was in Georgia during all of 1999 except for 30 days when she was outside Georgia. Assuming Maria does not qualify for any exceptions provided in article 25(2), she will be considered a resident for all of 1999 because she was in Georgia more than 182 days in 1999.

Example 2

On February 1, 1998, Tamuna, a citizen of Georgia, entered into a 5-year lease with a Georgian enterprise that wanted to convert her house into a hotel. According to the lease contract Tamuna is to receive 1500 GEL per month throughout the lease period. Tamuna left Georgia on February 2, 1998. Tamuna did not leave due to work with the Georgian State Service.

On December 31, 1998, Tamuna will determine her resident status as follows.

<u>Month</u>	<u>Days in Georgia</u>
January	31
February	<u>2</u>
Total days in Georgia in 1998	33

Tamuna will be considered a non-resident for all of 1998 because she was in Georgia less than 182 days in 1998. She will report income received from the

rental of her house under article 29(18)(k) (income from a Georgian source) and will be entitled to any deductions available to non-residents. She will file a tax return according to article 87(5).

1.26 Physical Person Entrepreneur

1. Refer to Tax Code.
2. A physical person who engages in an entrepreneurial activity in violation of established procedures for registration and receipt of a license, certificate, or any other required document is for tax purposes considered to be an entrepreneur engaged in an entrepreneurial activity.

Example

Giorgi drills for and extracts mineral water in Georgia even though he does not have a license to conduct this activity. Even though he does not have the required license Giorgi is considered to be a physical person entrepreneur engaged in an entrepreneurial activity. As a result, Giorgi is subject to tax on any income he earns from this activity. (Under articles 192 – 196 Giorgi will also be subject to tax on the use of natural resources.)

1.29 Definitions

Refer to article 29 for definitions of terms used in the Tax Code. In addition to those provided in the Tax Code, the following additional definitions related to VAT are provided.

25. “Indirect tax” - tax (including but not limited to VAT and excise) which is imposed as an addition to the price of the supplied goods, fulfilled works or performed services and which is payable by the customer when purchasing the good at the price increased by this tax.
The liability to pay the indirect tax to the budget is borne by the supplier of a good, work or services.
 - a. Input tax -VAT paid by a VAT registered person in respect of goods and services supplied to him, or in respect of the importation of goods and services, which he has paid to the customs authorities.
 - b. Input tax credit - VAT that is credited to a VAT taxpayer on goods and services that he has purchased for use in his economic activity or for onward supply to his customers.
 - c. Taxable supply – the supply of goods, fulfillment of works or rendering of services made in Georgia other than an exempt supply.

END OF GENERAL PROVISION INSTRUCTIONS

PART II. INCOME AND PROFIT TAXES

Chapter 4. Income Tax

2.35 Taxpayers

Taxpayers are resident and non-resident physical persons as defined in article 25 who are subject to tax on objects of taxation provided in article 36.

2.36 Object of Taxation

1. A resident physical person as defined in article 25 of the Tax Code is subject to tax on taxable income at the income rates provided in article 42. Taxable income is determined on a calendar year basis and represents the total gross income from Georgian and non-Georgian sources received by the resident during the calendar year, less deductions provided by the Tax Code.

Example

Giorgi, a resident physical person as defined in article 25, was employed by Firm VV from February 1, 1999 through December 31, 1999. Giorgi was unemployed during the month of January 1999. In 1999 Giorgi received 6000 GEL of wages from VV. In 1999 Giorgi also received 100 GEL equivalent for work performed at Firm BB located in Warsaw, Poland. Giorgi was a contractor, not an employee, of BB. In 1999 Giorgi incurred 50 of deductible expenses in connection with his work at BB that were not reimbursed by BB. For the 1999 calendar year Giorgi will compute taxable income as follows.

<i>Gross Income</i>		
<i>Wages from VV</i>	<i>6000</i>	
<i>Income from BB</i>	<u><i>100</i></u>	
<i>Total gross income</i>		<i>6100</i>
<i>Less:</i>		
<i>Deductible expenses connected to BB</i>	<i>(50)</i>	
<i>Monthly (9 GEL * 11 months)</i>	<u><i>(99)</i></u>	
<i>(per article 41)</i>		
<i>Total deductions</i>		<u><i>(149)</i></u>
<i>Taxable income</i>		<i>5951</i>

Because Giorgi is considered a resident physical person he must include his wages from Firm BB, a non-Georgian source, in taxable income. Because Giorgi is not an employee of BB he is entitled to deduct allowable expenses he incurred in connection with the income he earned from BB. Giorgi will compute his tax liability on 5951 GEL of taxable income using rates provided in article 42. Tax on wages received from VV will be withheld and paid at the source (VV). Giorgi must submit a return under article 87(1) listing the income received from BB and related deduction.

2. A non-resident physical person as defined in article 25 of the Tax Code who engages in an activity in Georgia through a permanent establishment as defined in article 17 is subject to tax on taxable income earned from the activity. Taxable income represents the total gross income received by the non-resident during the calendar year from permanent establishment, less deductions provided by the Tax Code. Taxable income is determined on a calendar year basis.

Example 1

Inga, a citizen of Sweden, is a non-resident taxpayer as defined in article 25. From September 1 through December 31, 1999 was employed in Georgia by Firm MED. Assume for this example that Firm MED is considered a permanent establishment as defined in article 17. Inga received 9000 GEL of income from her work at MED and incurred 200 of expenses in connection with her work at MED. For the 1999 calendar year Inga will compute taxable income as follows.

<i>Gross Income</i>		
<i>Earnings from MED</i>	9000	
<i>Total gross income</i>		9000
<i>Less:</i>		
<i>Monthly (9 GEL * 4 months)</i>	(36)	
<i>(per article 41)</i>		
<i>Total deductions</i>		<u>(36)</u>
<i>Taxable Income</i>		8964

Inga will compute her tax liability on 8964 of taxable income using rates provided in article 42. The tax will be withheld at the source (MED). Inga is entitled to a monthly deduction under article 41 for the period she was employed at Firm MED. However, article 49(4) precludes her from deducting the 200 GEL in work-related expenses she incurred.

Example 2

Assume the same facts as in example 1, but that Inga works for MED on a contract rather than employment basis. For the 1999 calendar year Inga will compute taxable income as follows.

<i>Gross Income</i>		
<i>Earnings from MED</i>	9000	
<i>Total gross income</i>		9000
<i>Less:</i>		
<i>Deductible expenses</i>	(200)	
<i>(per article 41)</i>		
<i>Total deductions</i>		<u>(200)</u>
<i>Taxable Income</i>		8800 GEL

Inga will compute her tax liability on 8800 GEL of taxable income using rates provided in article 42. The tax will be withheld at the source (MED). Inga is not entitled to a monthly deduction under article 41 because she is not an employee

of MED. However, she is entitled to a deduction for 200 GEL in work-related expenses she incurred.

3. Income received by a non-resident physical person (as defined in article 25) that was received from a Georgian source (as defined in article 29(18)) other than a permanent establishment is subject to taxation at the source of payment in accordance with article 64. (Refer to article 64 for applicable rates.) Non-residents receiving Georgian source income that is taxed at the source of payment may file a tax declaration in which they can deduct related expenses and obtain a refund of any excess tax withheld. (See article 87(5).)

Example

During calendar year 1999 Inga, a citizen of Sweden, is a non-resident taxpayer as defined in article 25. In 1999 Inga received 1000 GEL of dividend income from Georgian Firm GG, which is not considered a permanent establishment under article 17. She incurred 20 GEL in expenses in connection with this dividend income. Because Inga is a non-resident physical person she will be taxed on this dividend income at the source of payment per article 64 and at the rate defined in article 62. Inga is not entitled to deduct 20 GEL of expenses she incurred in connection with this dividend income unless she files a return pursuant to article 88(5).

4. A non-resident physical person (as defined in article 25) who receives from a Georgian source employment income or income from the sale of the property used for entrepreneurial activity is subject to income tax on the gross income received less deductions which are attributable to such income. Income from the sale of property includes income in the form of royalties and income from the sale or transfer of property. Refer to article 29(18) for additional information on items that constitute income from a Georgian source. The tax is computed and paid on a calendar year basis.

Example

Inga, a citizen of Sweden, is a non-resident taxpayer as defined in article 25. From September 1 through December 31, 1999 she was employed in Georgia at Firm CC, a Swedish firm considered a permanent establishment as defined in article 17. This was her principal place of employment during this period. During 1999 Inga received 8000 GEL of employment income from CC and incurred 400 of employment expenses in connection with her work that were not reimbursed by CC. In 1999 Inga also received 1000 Swedish Kroner (SK, Swedish currency) for work she performed for Firm DD, a Swedish firm in Stockholm that is not considered a permanent establishment as defined in article 17 and is not considered income from a Georgian source under article 29(18). She incurred 100 SK in deductible expenses for her work for DD. Inga also received 2000 of income on the sale of property located in Georgia. Inga incurred 200 of deductible expenses in connection with the sale of this property.

For the 1999 calendar year Inga will compute taxable as follows.

<i>Gross Income from Employment</i>	
<i>Wages from CC</i>	<i>8000</i>
<i>Less:</i>	
<i>Monthly (9 GEL * 4 months)</i>	<i><u>(36)</u></i>
<i>(per article 41)</i>	
<i>Taxable income from employment</i>	<i>7364</i>
 <i>Gross Income from Property</i>	
<i>Income from property</i>	<i>2000</i>
<i>Less:</i>	
<i>Expenses connected to sale of</i>	
<i>property</i>	<i><u>(200)</u></i>
<i>Taxable income from property</i>	<i>1800</i>

Inga will compute her tax liability on 7364 of taxable wage income using rates provided in article 42. Inga is entitled to a monthly deduction under article 41 for the period she received wages from Firm CC. Article 49(4) precludes Inga from deducting the 400 GEL of expenses incurred in connection with her work at Firm CC. Wages received and expenses incurred in connection with Inga's work for Swedish Firm DD are not included in Inga's computation of Georgian taxable income because Inga is a non-resident physical person and DD is not considered a permanent establishment as defined in article 17.

Inga must file a return pursuant to article 88(1)(a) that includes income from the sale of property in Georgia and any deductible expenses incurred by Inga in connection with the sale of the property.

2.37 Gross Income

1. Resident taxpayers as defined in article 25 must include all income in gross income, regardless of where the income was earned or received.

Example

Eka, a resident of Georgia as defined in article 25, received the following types of income in 1999.

<i>Wages from Georgian Firm QW</i>	<i>2000</i>
<i>Wages earned and received in Austria from Austrian Firm EW</i>	<i>9000</i>
<i>(GEL equivalent)</i>	
<i>Interest income received in Ukraine from a Ukrainian bank</i>	<i><u>400</u></i>
<i>(GEL equivalent)</i>	
<i>Total gross income</i>	<i>11400 GEL</i>

2. Non-resident taxpayers defined in article 25 include in gross income only income received from Georgian sources as defined in article 29(18) , regardless of where the income was received.

Example

In 1999 Pierre, a non-resident of Georgia as defined in article 25, received 2000 GEL equivalent from Georgian Firm AA for consulting work performed in the same year. Firm AA paid Pierre in France. For Georgian tax purposes Pierre must include 2000 GEL in gross income.

3. All forms of income are included in gross income, including but not limited to cash and payments-in-kind received from economic activity during the tax year.
 - a. Income received in the form of wages is included in gross income.
 - b. Income from economic activity not connected with employment is included in gross income.
 - c. Income in the form of payment-in-kind is recorded in the recipient's gross income at the market price equivalent at the moment of receipt of the income.

Example

In January 1999 Georgian Firm SUG paid to each of its employees 100 kilograms of sugar in lieu of wages. At that moment of receipt of the sugar the market price of one kilogram of sugar was 0.80 GEL. In 1999 employees of SUG will include in gross income 80 GEL (100kg x 0.80) based on the receipt of sugar.

- d. In a joint ownership arrangement as defined in article 75 that does not involve the establishment of a separate legal person income and deductions will be allocated to the joint owners based on the owner's proportionate share of the joint ownership arrangement. The income and deductions will be included in the owners' taxable income computation.

Example 1

In 1999 Georgian residents David and Amiran entered into a joint ownership arrangement as defined in article 75. Under the arrangement David and Amiran rented a garage and equipment and operated a car repair service. David and Amiran did not establish a legal person for this activity. According to the agreement David contributed 60 percent of the funds needed to establish the enterprise and Amiran contributed 40 percent. Accordingly, profit and losses would be allocated 60 percent to David and 40 percent to Amiran based on their contributions. In 1999 the joint ownership arrangement produced the following:

	<i>Total</i>	<i>David</i>	<i>Amiran</i>
<i>Gross income</i>	10000	6000	4000
<i>Deductible expenses</i>	(4000)	(2400)	(1600)
<i>Total</i>	6000	3600	2400

In 1999 David and Amiran will include in their taxable income computations their respective income and deductions given above.

Example 2

George and David are attorneys and are permitted to practice law in Georgia. They agreed to work in the same office and divide all overhead and administrative expenses. They did not enter into a joint ownership arrangement as defined in article 75. Because they never entered into a joint ownership arrangement they will be taxed as physical persons and not as a legal entity. Income and deductions will be allocated according to their agreement.

- e. Payments in any form made on behalf of or for the benefit of a physical person or his/her dependents are considered income of the physical person.

Example

On November 1, 1999 Tika purchased a car from Firm CV for 4000 GEL. Tika is a dependent of Zura, who is employed by Firm BA. Tika paid 3500 GEL on November 1, and agreed to pay the remaining 500 GEL balance by December 31, 1999. On December 15, 1999 Firm BA paid the 500 GEL balance on Tika's loan on behalf of Zura. Zura must include the 500 GEL payment by BA in his 1999 income.

- f. Income imputed under article 134(4) resulting from the loss or failure to use excise stamps must be included in gross income. Refer to instruction article 2.39(1)(a)(2) for guidance.

2.38 Income Received in the Form of Wages

1. Cash or cash-equivalents received from the performance of services or production of goods by an individual, including but not limited to income in the form of currency payments, goods, services or pensions received, is to be included in income in the form of wages in the year the individual receives the cash or cash-equivalent.
 - a. Cash or cash-equivalents received from previous, current or future employers is considered wage income.
 - b. An individual who may take possession of cash or cash equivalent is deemed to have received it.
 - c. Taxes on wage income are withheld according to procedures provided in article 88.
2. The amount of income deemed to be wages is the market value, as provided in article 27, of the cash or cash equivalent received by the individual reduced by any portion of the benefit that was paid directly by the individual. The amount to be included in income is computed on a monthly basis and is included in the tax year that the year the cash or cash equivalent is received by the individual. The following circumstances give rise to wage income:
 - a. If an automobile is made available for the private use of an individual the individual must include in income in the form of wages an amount computed as follows: 0.05 percent of the value of an automobile of the type provided multiplied by the number of days the automobile is available for use. No amount is included in income if the use of the automobile is for business purposes only or if the employee does not use the automobile.

Example 1

Georgian Firm UU provided a 1998 Volga automobile for its employee, Giorgi, to use for 3 months during 1999. Giorgi was not required to pay any fee for the use of the Volga, but was required to pay for all gasoline used. Giorgi accepted the use of the Volga and used it for 90 days. Giorgi used the Volga 60 percent for business purposes and 40 percent for personal use. In 1999 Giorgi would include the following amount in wage income for the use of the Volga.

<i>Value of 1998 Volga at the beginning of the 1999 calendar year:</i>	<i>12000</i>
<i>GEL</i>	
<i>Multiplier</i>	<i>* 0.05 %</i>
	<i>6</i>
<i>Number of days used (total)</i>	<i>* 90</i>
<i>Total benefit</i>	<i>540</i>
<i>Personal use</i>	<i>* 40 %</i>
<i>Amount included in wage income received by Giorgi</i>	<i>216</i>

The costs Giorgi incurred for gasoline may not be used to reduce the amount included in wages because gasoline was not a component of the benefit received.

Example 2

In 1999 Khatuna, an employee of Georgian Firm YY, rented a 1996 Zhiguli automobile from YY for 5 days at a total cost of 6 GEL. Khatuna used the Zhiguli solely for private use. In 1999 Khatuna would include the following amount in wage income for the use of the Zhiguli.

<i>Value of 1996 Zhiguli at the beginning of the 1999 calendar year:</i>	<i>4000 GEL</i>
<i>Times multiplier</i>	<i>* 0.05 %</i>
	<i>2</i>
<i>Number of days used (total)</i>	<i>* 5</i>
	<i>10</i>
<i>Personal use</i>	<i>* 100 %</i>
<i>Total benefit</i>	<i>10</i>
<i>Amount paid by Khatuna for the use of the Zhiguli</i>	<i>(6)</i>
<i>Amount included in wage income received by Khatuna</i>	<i>4 GEL</i>

- b. Receipt of a loan at an interest rate that is lower than the market interest rate for loans of that type will be considered wage income to the loan recipient. The amount of wage income will be computed as follows.

Market rate of interest charged by banks (the interbank interest rate) on similar loans on the date the loan is made
 Less: the interest actually charged to the loan recipient
 Equals: Interest rate difference
 Times: Amount of loan
 Equals: Amount considered wages to the loan recipient.

The amount determined above will be included in wage income in the periods that the loan is outstanding.

Example 1

On January 1, 1999 Maia received loan of 5000 GEL from her employer Firm TT. Under the terms of the loan Maia was required to repay the loan, plus 1 percent, on January 1, 2000. On January 1, 1999 the market interest rate charged by banks for a similar loan was 3 percent. The difference between the market interest rate and the rate of the loan is 2 percent. In 1999 Maia will compute her income from the loan as follows.

<i>Interest rate charged by banks</i>	<i>3 %</i>
<i>Interest rate charged by Firm TT</i>	<i>(1 %)</i>
<i>Excess of market over Firm TT interest rate</i>	<i>2 %</i>
<i>Multiplied by amount of loan received</i>	<i>5000 GEL</i>
<i>Equals</i>	<i>100 GEL</i>
<i>Portion of 1999 in which loan is outstanding 365/365</i>	<i>* 1</i>
<i>Imputed loan income to be included as wage income</i>	<i>100 GEL</i>
<i>This amount (100 GEL) will be included in wage income of the employee.</i>	

Example 2

Assume the same facts as in Example 1 above, but the 1-year loan was made on July 1, 1999. In 1999 Maia will compute her income from the loan as follows.

Interest rate charged by banks	3 %
Interest rate charged by Firm TT	<u>(1 %)</u>
Excess of market over Firm TT interest rate	2 %
Multiplied by amount of loan received	<u>5000 GEL</u>
Equals	100 GEL
Portion of 1999 in which loan is outstanding 182/365	<u>* .50</u>
Imputed loan income to be included as wage income	50 GEL

This amount (50 GEL) will be included in Maia's wage income in 1999. Maia also will include imputed interest in wage income in 2000 for the period the loan is outstanding.

Example 3

Assume the same facts as in Example 2 above, but that Firm TT designates the 5000 GEL as a dividend for the year 2000. Firm TT does not charge any interest on the 5000 GEL paid to Maia. On June 30, 2001 TT declares and pays a dividend. The amount of Maia's dividend (5000 GEL) equals the amount TT paid to Maia on July 1, 2000.

Even though TT designated this payment as a dividend it will be considered a loan because it was paid prior to the declaration and payment of dividends for the year 2000. (Refer to the Law on Entrepreneurs for guidance concerning the declaration of dividends.) In 1999 Maia will compute her income from the loan as follows.

Interest rate charged by banks	3 percent
Interest rate charged by Firm TT	<u>(0 percent)</u>
Excess of market over Firm TT interest rate	3 percent
Multiplied by amount of loan received	<u>5000 GEL</u>
	150 GEL
Portion of 1999 in which loan is outstanding 182/365	<u>* .50</u>
Imputed loan income to be included as wage income	75 GEL

This amount (75 GEL) will be included in wage income of the employee and in wage expense of the employee in 1999.

Maia also will include imputed interest of 75 GEL in wage income in 2000 for the period the loan is outstanding. When the dividend is issued on June 30, 2001, the 5000 GEL loan will be considered to be repaid and 5000 GEL will be deemed paid to Maia in the form of a dividend. Maia will be subject to a tax on the dividend according to articles 39 and 62.

- c. The fair market value of any goods or services paid or provided by to an individual for the performance of services are considered wages if they are accepted by the individual.

Example 1

In January 1999 Georgian Firm SUG paid its employee Misha 100 kilograms of sugar in lieu of wages. At that moment of Misha's receipt of the sugar the market price of one kilogram of sugar was 0.80 GEL. The 80 GEL (100kg x 0.80) will be considered wages and will be included in Misha's wage income.

Example 2

Firm XX paid for repairs to the residence of Zura, its employee. The market price of the repairs made was 2000 GEL. The 2000 GEL amount will be considered wages and will be included in Zura's wage income.

- d. All amounts paid by the employer for educational expenses of employees or dependents of employees are considered wages (except training programs connected directly with the performance of the employee's duties).
1. For purposes of this subarticle the definition of "dependent" as used in the Civil Code applies. A dependent can be claimed by only one taxpayer.
 2. Amounts paid for educational expenses of employees (not dependents of employees) that are incurred to improve the current duties performed by the employee are not considered wage income, regardless how such amounts are paid to the educational institution.

Example 1

In 1999 Firm RR paid 500 GEL to university for the tuition of Nino. Nino is the daughter of Natya, an employee of RR. Nino is a dependent of Natya. Nino is not an employee of Firm RR. In 1999 the 500 GEL tuition payment will be considered wages and will be included in Natya's wage income.

Example 2

In 1999 Firm RX paid 300 GEL for an accounting training course for its employee Rosiko. Rosiko is employed as an accountant at RX. The 300 GEL paid by RX is not considered wages because it was incurred to provide training for a duty currently performed by Rosiko. The 300 GEL will not be included in Rosiko's wage income.

- e. Other types of expenses incurred by an employee that are reimbursed by the employer are considered wages in the year the reimbursement occurred. Reimbursement by the employer can be in the form of cash or cash equivalents. Examples of reimbursed expenses that will be included in income include expenses for:
- 1) transportation, other than those expenses provided in a. above for the private use of a car, that are within the norms approved by the Ministry of Finance of Georgia;

- 2) repairs and other services;
- 3) meals;
- 4) medical treatment, including sanatoriums;
- 5) education; and
- 6) publications.

Example

In 1999 Zviad, an employee of Firm QQ, paid 300 GEL for subscriptions to daily newspapers. In 1999 QQ reimbursed Zviad for 220 GEL of these expenses. The 220 GEL are considered wages and will be included in Zviad's wage income.

- f. The portion of a debt or obligation due by an employee to an employer and subsequently forgiven by an employer is considered wages in the year the debt or obligation is forgiven.

Example

On November 1, 1999 Firm ER loaned 1000 GEL to Nato, its employee. The principal amount of the loan and interest at the market rate was to be repaid in six months. On November 15, 1999 ER forgave the loan in its entirety. The 1000 GEL forgiven by ER is considered wages and in 1999 will be included in Nato's wage income.

- g. The cost of the health, life accident and other insurance premiums paid by an employer on behalf of its employees is considered wages.

Example

In 1999 Firm LI paid 150 GEL for life insurance premiums for Harry, its employee. The 150 GEL paid by LI is considered wages, and in 1999 will be included in Harry's wage income.

- h. Any other circumstances in which the employee receives a benefit from his/her employer that are not specifically excluded from wages will be considered wages. If the benefit received is not in the form of GEL the market value, as defined in article 27, of the benefit is the amount that is considered wages. Refer to instruction article 2.37(6) for an example.
3. Travel expenses and representation expenses incurred by an employee during the course of his/her employment that are paid by the employer, either directly or through reimbursement of the employee, are considered wages unless the expenses are within the limits of norms established by the Ministry of Finance of Georgia. If no norms are in effect travel expenses and representation expenses will be deductible to the extent they are ordinary and necessary for the performance of the employer's business. If the deduction is challenged by a tax agency the burden is on the taxpayer to prove that the amount deducted is ordinary and necessary. If only a portion of the expenses incurred satisfy the exceptions above, any excess amounts are considered wages.

Example

In March 1999 Peter, an employee of Firm HI, traveled to Vilnius to conduct business. Peter worked 2 days in Vilnius, and stayed one extra day for personal reasons. While in Vilnius Peter stayed for 3 days in a hotel that cost 120 (GEL equivalent) per night. Peter paid 360 (GEL equivalent) for the 3 nights, and was reimbursed by Firm HI for the total expenses (360 GEL). No norms were established by the Ministry of Finance for the period when Peter stayed in Vilnius. Peter will include a portion of his hotel expenses as wages determined as follows (all amounts in GEL equivalent).

<i>Total lodging expenses (3 days @ 360 GEL)</i>	<i>360</i>
<i>Ordinary and necessary expense (2 days @ 120 GEL)</i>	<i>(240)</i>
<i>Amount of expenses considered wages</i>	<i>120 GEL</i>
<i>Peter will include 120 GEL as wage income.</i>	

4. The amount of all benefits listed in subarticles 2 and 3 include excise, value added tax, and any other taxes paid by or subject to payment by the employer.

Example

Giorgi is an employee of Firm EW. EW reimbursed Giorgi 100 GEL for repairs Giorgi had made to his automobile. According to the VAT invoice 20 GEL of the total 100 GEL repair cost constituted value added tax (VAT). Giorgi will include in his income the total amount (100 GEL), including the portion representing VAT, that was paid by EW.

2.39 Income from Economic Activity Not Connected with Employment

1. Income earned or imputed from an economic activity that is not due to an employment relationship is subject to income tax unless the income is exempted under article 43. Taxable income includes, but is not limited to, actual or imputed income from the following activities:
 - a. Income from entrepreneurial activities as defined in article 8, including but not limited to:
 - 1) Income received from the performance or supply of good and services
 - 2) income stipulated in article 134(4) of the Tax Code resulting from:
 - A) the loss of excise stamps, or
 - B) the failure by importers to import excisable goods within six months from the date of receipt of excise stamps and failing to return the stamps to local producers
 that is not due to force majeure.

Example 1

*Giorgi, a physical person entrepreneur as defined in article 26, produces and bottles sparkling wine. In 1999 Giorgi bought 2500 excise stamps of “d” series and in “g” capacity (liters) to affix to 0.85 liter bottles. In the accounting period he bottled and delivered 1530 liters of sparkling wine in 0.85 liter bottles, for a total of 1800 bottles (1530 liters / 0.85 bottles). The selling price per bottle was 3.50 GEL. Giorgi used 1800 of the 2500 excise stamps, and the 700 remaining stamps were lost or destroyed. The loss or destruction was not due to force majeure. (Article 134(4) provides that shortages of excise stamps due force majeure are not subject to tax.) As a result, 2450 GEL (3.50 GEL sales price per bottle * 700 lost stamps) will be included in the 1999 income reported by Giorgi.*

Example 2

*On April 10, 1999, Michael, a physical person entrepreneur as defined in article 26, who imports liqueur, bought 1500 excise stamps of “a” series and in “l” capacity (liters) to affix to 0.5 liters bottles of liqueur to be imported. However, Michael was unable to import the liqueur for six months, which was not due to force majeure. Michael did not return the above mentioned excise stamps. During the six-month period beginning on April 10, 1999, the market price of the “l” capacity (in liters) liqueur was fixed at 3 GEL. The imputed value of the import amounted to 4500 GEL (1500 bottles * 3 GEL per bottle). Michael is deemed to have imported 1500 bottles of liqueur inside Georgia. As a result, 4500 GEL will be included in the 1999 income reported by Michael.*

- 3) Gain from the sale of assets used for entrepreneurial activities.

Example

Zviad, a physical person entrepreneur as defined in article 26, purchased a tractor for 12000 GEL on January 3, 1999. The tractor was purchased for use in Zviad’s entrepreneurial activities. During 1999 Zviad did not own any other assets in the asset class (class 2 per article 54). On December 28, 1999 Zviad sold this tractor for 15000 GEL, resulting in a gain of 3000. In this case 3000 GEL will be included in Zviad’s income from entrepreneurial activities.

- 4) Income received from the restriction of an entrepreneurial activity or as a result of its cessation of activities.

Example

In 1999 Sophie, a physical person entrepreneur as defined in article 26, established an enterprise in the Kaheti region that would produce soap. Firm SOP, a soap-producing enterprise, already existed in Kaheti region. SOP offered to pay Sophie 1000 GEL if she would not produce soap in 1999. Sophie accepted SOP’s offer and received 1000 GEL in 1999. The 1000 GEL Sophie received from SOP will be included in Sophie’s 1999 income.

- 5) Income from the sale of fixed assets and included in income in accordance with article 54(7). If the amount received from the sale of fixed assets exceeds the value balance of group at the end of the year the excess amount will be included in income and the value balance of the group will be equal to zero.

Example

Nato, a physical person entrepreneur as defined in article 26, purchased two computers on January 3, 1999 to be used in her entrepreneurial activities. Each computer cost 3000 GEL. On December 28, 1999 Nato sold one computer for 7000 GEL. Per article 54 the computers are classified as group 1 assets. Assume Nato has no other Group 1 assets. Nato will compute her income from this transaction as follows.

Group 1 Assets

<i>Beginning balance, 1 January 1999</i>	<i>0</i>
<i>Total purchases during 1999</i>	<i>6000</i>
<i>Total sales during 1999</i>	<i><u>(7000)</u></i>
<i>Net balance at 31 December 1999</i>	<i>(1000)</i>

In this case 1000 GEL will be included in Nato's income from entrepreneurial activities and the asset balance of Group 1 will be reduced to zero.

- 6) Amounts included in income per article 79

Example

Nato, a physical person entrepreneur as defined in article 26, incurred and deducted business expenses of 500 GEL in 1998. In 1999 Nato was reimbursed for 100 GEL of the expenses previously deducted. Nato will include 100 GEL in income in 1999.

- b. Income from non-entrepreneurial activity, including but not limited to:

- 1) dividends (taxed in accordance with article 62)
- 2) interest (taxed in accordance with article 63)
- 3) lease or rental of property
- 4) royalties
- 5) debts being written off

Example

In 1998 Edward loaned Eka 1000 GEL. Eka did not repay any portion of the loan. In 1999 Edward released Eka from her obligation under the loan. In 1999 Eka must include 1000 GEL in income.

- 6) gain from the sale of assets, other than gains described in subarticle (a), including but not limited to:

- A) gains for the sale of real property, including land, structures and immovable equipment that is used for entrepreneurial activity. (See also article 43(g) for gains from the sale of tangible assets that are exempt from income tax).

Example

Nato leased a building that was used by the tenants for entrepreneurial activity. The leasing of the building is a non-entrepreneurial activity for Nato. On April 1, 1999 Nato sold this building for 75000 GEL. She had purchased it in 1998 for 50000 GEL. In 1999 Nato will include in income the 25000 GEL gain (75000-50000) on the sale of the building. However, the gain will be exempt from tax under article 43(g).

- B) gains from the sale of securities, shares of a legal person and other instruments of ownership

Example

Vato is engaged in the activity of buying and selling shares of legal persons. This is a non-entrepreneurial activity for Vato. Vato purchased five shares of Firm WE in 1998 for 500 GEL per share. In 1999 Vato sold four shares of WE for 800 GEL per share. The gain on the sale of the shares will be computed as follows.

<i>Sale proceeds (4 * 800/share)</i>	<i>3200</i>
<i>Cost of four shares (4 * 500/share)</i>	<i><u>2000</u></i>
<i>Gain</i>	<i>1200</i>

In 1999 Vato will include in income the 1200 GEL gain from the sale of four shares. However, the gain will be exempt from tax under article 43(g).

- C) gains from the sale of precious metals and stones, jewelry, antiques and other objects or art

Example

Gia buys and sells paintings and art objects. This is a non-entrepreneurial activity for Gia. In 1999 Gia purchased a painting for 3000 GEL. Gia sold the painting in 1999 for 5000 GEL. In 1999 Gia will include 2000 GEL in income (5000 – 3000) resulting from the sale of the painting. However, the gain will be exempt from tax under article 43(g).

- 7) other gains or income that are derived from non-entrepreneurial activities, excluding salaries and contributions of capital. Refer to article 38(2) for rules on determining gains.

2.40 Adjustment of Gross Income

Dividends and interest received by physical persons that was taxed at the source of payment in Georgia in accordance with article 62 or 63 are excluded from the physical person's gross income.

Example

In 1999 Zura received (in GEL):

wages	3600
dividends	120
interest	80.

The dividends and interest were taxed at the source of payment in accordance with articles 62 and 63, respectively. In 1999 Zura will include only the 3600 of wages in gross income.

2.41 Right to Monthly Deductions

1. A physical person is entitled to deduction in the amount of 9 GEL (the “non-taxable minimum”) for each calendar month in which the individual worked in the course of a tax year, regardless of whether the individual was paid in the month worked. This deduction is allowed only against wages received from the person's principal place of employment.

Example 1

*Inga is an employee of Firm TT, her principal place of employment. Inga received 200 GEL in wages each calendar month during 1999. Inga is entitled to total monthly deductions in 1999 of 108 GEL (12 months * 9 GEL).*

Example 2

*Inga is an employee of Firm TT, her principal place of employment. Inga earned 200 GEL in wages each calendar month during 1999. Firm TT paid Inga 1200 in wages on 2 July 1999 and 1200 on 30 December 1999. Although Inga received income from Firm TT in only two months in 1999, she is entitled to monthly deductions for all of the months she worked for TT in 1999. The total of Inga's 1999 monthly deductions will be 108 GEL (12 months * 9 GEL).*

Example 3

*Inga is an employee of Firm TT, her principal place of employment. Inga earned 30 GEL in wages in eight separate months during 1999. Inga also worked for Firm SS for 4 months during 1999. SS paid Inga 100 GEL in 4 separate months in 1999. Inga is entitled to total monthly deductions for the eight months that she received income from her principal employer in 1999. Her monthly deductions totals 72 GEL (8 months * 9 GEL).*

2. The monthly deductions allowable during the course of a tax year are aggregated from the beginning of the tax year.

3. A physical person who changes his/her principal place of employment during a calendar year must submit a statement listing the income received and taxes paid at the previous principal place of employment.
4. The tax on income is calculated on a monthly basis on the cumulative income received from the employer to date, less cumulative monthly deductions and amounts withheld. Calculation of tax liability at a new principal place of employment will include income, monthly deductions and amounts withheld at the previous place of employment during the tax year.

Example

From 1 January through 12 July 1999 Zurab was an employee of Firm FF, his principal place of employment. Zurab was fired from FF on 12 July 1999. In 1999 Zurab received 315 GEL from FF while employed at FF. Zurab was entitled to a monthly deduction of 9 GEL. As a result, he was subject to tax as follows.

<i>Income received</i>	<i>315</i>
<i>Total monthly deduction (9 * 7 months)</i>	<i>(63)</i>
<i>Taxable income</i>	<i>252</i>
<i>Tax due and withheld by employer</i>	<i>31.80 GEL</i>
<i>(252-200 GEL * 15 percent) +24</i>	

On 25 July 1999 Zurab began working at Firm UI. Zurab received 15 GEL in wages from UI in July. Zurab submitted a statement to UI listing his previous place of employment (FF) and the income he received from FF. FF will compute Zurab's tax liability for July as follows.

<i>Income received from principal employers in 1999 (315+15)</i>	<i>330</i>
<i>Total monthly deduction (9 * 7 months)</i>	<i>(63)</i>
<i>Taxable income</i>	<i>267</i>
<i>Tax due and withheld by employer</i>	<i>34.05</i>
<i>(267-200 GEL * 15 percent) +24</i>	
<i>Less tax withheld by previous employer</i>	<i>(31.80)</i>
<i>(252-200 GEL * 15 percent) +24</i>	
<i>Tax liability on wages received in July from Firm UI</i>	<i>2.25 GEL</i>

5. In months in which an employee does not work due to vacation, income tax and monthly deductions are computed according to the following rules.
 - a. The monthly deduction also applies to months during which the individual is on paid vacation. During vacation periods the individual's income tax is calculated based on gross income received from the beginning of the tax year for both working and vacation months.

Example

Valentina, an employee of Firm TY, worked from 1 January 1999 through 31 July and received 50 GEL per month. Valentina took a paid vacation from August 1 through September 9, and resumed working on September 9. She continued working and receiving wages at TY through December. Valentina received her August and September wages totaling 100 GEL (2 months * 50 GEL) on 30 September.

Valentina will compute her August and September income tax as follows.

Income from January through July (7 months * 50)	350
Income tax paid through July (24 + 15 percent * 150)	46.50
Income received in August	0
Tax due in August	0
Income received in September	<u>100</u>
Total income received through September	450
Less monthly deductions (9 months * 9 GEL)	<u>(81)</u>
Taxable income	369
Tax (46.5 + 17 percent * (369-350))	49.23
Less previous taxes paid	<u>(46.50)</u>
September income tax liability	2.73

- b. Tax on an employee who takes a vacation is computed on the total gross income received (including income received during vacation periods) from the principal employer as of the beginning of the year.

Example

From the beginning of 1999 Sasha was an employee of Georgian Firm EW. Sasha took a vacation from August 10 through September 24, 1999 for a total of 45 days. Through September Sasha received 586 GEL in gross income from EW during the period he worked, and an additional 60 GEL during his vacation period. In September Sasha will be subject to the following tax liability.

Total gross income from work period, through September	586
Total gross income from vacation period through September	<u>60</u>
Total gross income through September	646
Tax per article 42 (89 + 20 % * [646-600])	83.05
Total gross income from work period, through September	586
Less: Non-taxable minimum (9 months * 9 GEL)	<u>(81)</u>
Taxable non-vacation income	505
Tax per article 42 (46.5 + 17 % * [505-350]), withheld	<u>(72.85)</u>
Tax due on 60 GEL vacation pay	10.20

- c. If a vacation period covers two tax years, vacation pay received during the first tax year that is attributable to the vacation period in the second tax year will be included in gross income in the first tax year.

Example

Inga, an employee of Georgian Firm GA, took a vacation from December 19, 1998 through January 17, 1999. In December 1998 Inga received vacation pay of 150 GEL, 65 GEL attributable to December 1998 and 85 GEL attributable to January 1999. Inga will include the total 150 GEL in her 1998 income.

2.42 Income Tax Rates

1. Taxable income of a physical person is taxed at the rates specified in article 42.
2. The income tax calculated according to subarticle 1 is reduced by the amount of tax paid or withheld on dividends and interest received by the physical person in the tax year, subject to a maximum of 3000 GEL of dividends and interest.
3. Evidence confirming the payment of tax on dividends and interest must be provided in order to received credit for taxes paid on dividends and interest.
4. Any excess in a tax year of taxes paid on dividends and interest over the individual's income tax liability cannot be carried forward to future periods.
5. Taxes paid on dividends and interest over 3000 GEL cannot be taken as a credit against income taxes and cannot be carried forward to future periods.

Example 1

*Inga, a physical person, was employed for 10 months in 1999. On her return Inga reported income, excluding dividends and interest, of 670 GEL. During 1999 Inga received 350 GEL in interest income. Per article 63, taxes of 35 GEL (350 GEL * 10 percent) were withheld at the source of payment of the interest. Inga has evidence confirming the payment of the 35 GEL in taxes Inga will compute her 1999 tax liability as follows.*

<i>Income excluding dividends and interest</i>	<i>670</i>
<i>Monthly deduction per article 41 (9 GEL * 10 months)</i>	<i>(90)</i>
<i>Taxable income</i>	<i>580</i>
<i>Tax due per article 42 (46.5 GEL + 17 percent of income exceeding 350 GEL)</i>	<i>85.6</i>
<i>Tax credit for interest paid</i>	<i>(35)</i>
<i>Net tax due</i>	<i>50.60 GEL</i>

Example 2

Assume the same facts as in Example 1, but there is no evidence confirming payment of the 35 GEL tax on the interest income Inga received. In this case Inga will not be entitled to the 35 GEL credit for tax paid on interest. Inga will have a tax liability of 85.6 GEL.

Example 3

*Inga, a physical person, was employed for 10 months in 1999. On her return Inga reported income, excluding dividends and interest, of 670 GEL. During 1999 Inga received 3500 GEL in interest income. Per article 63, taxes of 350 GEL (3500 GEL * 10 percent) were withheld at the source of payment of the interest. Inga has evidence confirming the payment of the 350 GEL in taxes. Inga will compute her 1999 tax liability as follows.*

<i>Income excluding dividends and interest</i>	<i>670</i>
<i>Monthly deduction per article 41 (9 GEL * 10 months)</i>	<i><u>(90)</u></i>
<i>Taxable income</i>	<i>580</i>
<i>Tax due per article 42 (46.5 GEL + 17 percent of income exceeding 350 GEL)</i>	<i>85.6</i>
<i>Tax credit for interest paid (maximum 300 GEL)</i>	<i><u>(300)</u></i>
<i>Net tax due</i>	<i>0</i>

*The tax on the portion of dividends and interest that exceeds 3000 GEL ($[3500-3000] * 10 \text{ percent} = 50 \text{ GEL}$) cannot be carried forward and applied in future tax years. Furthermore, the tax on interest and dividends that could not be used ($300 - 85.6 = 264.4$) cannot be carried forward and applied in future tax years.*

Example 4

*Inga, a physical person, was employed for 10 months in 1999. On her return Inga reported income, excluding dividends and interest, of 6700 GEL. During 1999 Inga received 35000 GEL in interest income. Per article 63, taxes of 3500 GEL (35000 GEL * 10 percent) were withheld at the source of payment of the interest. Inga has evidence confirming the payment of the 3500 GEL in taxes. Inga will compute her 1999 tax liability as follows.*

<i>Income excluding dividends and interest</i>	<i>6700</i>
<i>Monthly deduction per article 41 (9 GEL * 10 months)</i>	<i><u>(90)</u></i>
<i>Taxable income</i>	<i>6610</i>
<i>Tax due per article 42 (89 GEL + 20 percent of income exceeding 600 GEL)</i>	<i>1291</i>
<i>Tax credit for interest paid</i>	<i><u>(300)</u></i>
<i>Net tax due</i>	<i>991</i>

*The tax on the portion of dividends and interest that exceeds 3000 GEL ($[35000-3000] * 10 \text{ percent} = 32000 \text{ GEL}$) cannot be carried forward and applied in future tax years.*

2.43 Tax Concessions

1. Income listed in a. through k. of article 43(1) that is received by physical persons is not subject to income tax. Even though such income is exempt for tax it must still be reported on the income recipient's tax return. Refer to article 87(1).
 - a. Salary and other payments received in Georgia by representatives and employees of foreign diplomatic and consular missions for the exercise of their official functions are not subject to income tax.
 - 1) The exclusion does not apply to income received by such representatives and employees that is not connected to their official functions.
 - 2) The exclusion does not apply to salaries and other payments paid to Georgian nationals by foreign diplomatic and consular missions.

Example

Uma, a citizen of Switzerland, is employed as a public relations officer at the Swiss Embassy in Tbilisi. In 1999 the Swiss Embassy paid Uma 40000 GEL in wages. In addition, in 1999 Uma performed three piano concerts in Tbilisi, for which she was paid 3000 GEL. The concerts were not connected to Uma's work at the Swiss Embassy.

Uma will not be subject to income tax on the wages she received from the Swiss Embassy. She will be subject to tax on the earnings (3000 GEL) she received from her piano concerts.

- b. The value of property received by gift or inheritance is not subject to income tax.

Example

Angelica, a Georgian resident, inherited a building from her deceased father on May 1, 1999. The fair market value of the building on this date was 45000 GEL. Angelica will not be subject to income tax on the building she inherited.

- c. Grants, state pensions, state scholarships and state benefits (including benefits paid in connection with pregnancy and birth, benefits paid in connection with the loss of fitness for work as a result of injury and/or for the loss of a breadwinner) are not included in income.
 - 1) Grants include monetary and non-monetary awards provided by a grantor to a grantee for scientific research, health, social, ecological and other projects. Grantors may be government, public or private organizations or individuals. Refer to the Law of Georgia on Grants for detailed information on grants.

Example

Nino is a student at Georgia State University. In 1999 she received funds from GRT, a private, non-Georgian organization for scientific research work. No conditions are attached to the receipt of the funds. The funds Nino receives from this organization constitute a grant and are not included in Nino's 1999 income.

- 2) State pensions, state scholarships and state benefits (including benefits paid in connection with pregnancy and birth, benefits paid in connection with the loss of fitness for work as a result of injury and/or for the loss of a breadwinner) are not included in income. (Refer also to the Law on State Budgets.)

Example 1

Eka is an employee of Georgian firm KK. Eka took maternity leave from October 1, 2000 until March 31, 2001. During this period Eka received 30 GEL per month in maternity benefits from the state and 50 GEL in maternity benefits from KK. The maternity benefits Eka received from the state are not included in her taxable income. However, the maternity benefits she received from KK are included in her taxable income.

Example 2

Zviad is an employee of ZZ, a road construction company. In 1999 Zviad suffered an accident while performing his work. As a result of the accident Zviad was no longer able to perform his work. Pursuant to legislation the Road Fund of Georgia paid Zviad 1500 GEL for his injury. Zviad will not include the 1500 GEL in income because it was paid by the state on account of Zviad's injury.

Example 3

Dato was the primary supporter ("breadwinner") in his family. Dato died in 1999. On account of Dato's death the state granted Dato's wife a monthly benefit of 45 GEL. Dato's wife will not include the 45 GEL/month in income because it was paid by the state on account of the death of a breadwinner.

- d. Alimony received is not subject to income tax. Alimony arises from a family relationship (including but not limited to marriage or adoption) and may be paid to divorced spouses, children, disabled persons and other family members. Refer to Chapter 5 of the Civil Code of Georgia for additional information on what types of payments constitute alimony.

Example

Nino and her former husband, Dato, are divorced. They have one minor child, Luda. Dato pays Nino 100 GEL per month--60 GEL of this amount is designated for Nino and 40 GEL for Luda. The entire 100 GEL is considered alimony and is not included in Nino's taxable income.

- e. Refer to Tax Code.
- f. Income received from the sale of agricultural products that have been grown or produced in a private household is not subject to income tax, provided the sale of the agricultural products occurs before the products are processed.

Example

Natasha, a physical person, grew and produced agricultural products in her private household. Natasha's agricultural production did not entail industrial

processing. In 1999 Natasha received 1000 GEL for the agricultural products she produced. In 1999 Natasha qualifies for the tax exemption provided under article 43(f). As a result, the 1000 GEL she received from agricultural production is exempt from income tax.

- g. Profit from the sale of tangible assets not used for entrepreneurial activity are not subject to income tax.

Example

Irina owns a flat in Tbilisi that she inherited from her mother in 1998. Irina sold the flat in year 2000 for 40000 GEL. Irina is not engaged in the entrepreneurial activity of buying and selling flats. Irina will not be subject to income tax on the sale of her flat.

- h.-k. Refer to Tax Code.

2. The taxable income of the physical persons described in article 43(2) is not subject to taxation up to 3000 GEL in the course of a calendar year:

- a.-c. Refer to Tax Code.

- d. For purposes of this article, a single mother is a woman without a legal husband who is the mother of a child, either through birth or adoption.
- e. The income received by a physical person who adopted a child, regardless of the nationality of the child or the place of adoption, will not be subject to income tax within the first year (twelve months) after the adoption was finalized.

Example 1

Sam, a Georgian citizen, adopted a Georgian child on 1 February 1999. During 1999 Sam's monthly income before deductions from January through December 1999 was 309 GEL per month. Beginning from 1 February 1999 (the date the adoption was finalized) Sam's monthly taxable income will be exempt from income tax, subject to a maximum 3000 GEL per calendar year. Any income Sam receives that exceeds the 3000 maximum will be taxed at rates specified in article 42. Sam will compute his 1999 income tax liability as follows.

<i>Total income (309 GEL per month * 12 months)</i>	<i>3708</i>
<i>Total monthly deductions (9 GEL * 12 months)</i>	<i><u>(108)</u></i>
<i>Total taxable income</i>	<i>3600</i>
<i>Exemption under article 43(2)(e)</i>	
<i>(309 * 11 months = 3399, subject to 3000 maximum in 1999)</i>	<i><u>(3000)</u></i>
<i>Taxable income after exemption</i>	<i>600</i>
<i>Tax liability per article 42 ([600-350] *17 percent + 46.5)</i>	<i>89</i>

Assuming Sam continues to receive monthly income of 309 throughout 2000, Sam will compute his 2000 income tax liability as follows.

Total income (309 GEL per month * 12 months)	3708
Total monthly deductions (9 GEL * 12 months)	<u>(108)</u>
Total taxable income	3600
Exemption under article 43(2)(e)	
(309 * 1 month = 309, subject to 3000 maximum in 2000)	<u>(309)</u>
Taxable income after exemption	3291
Tax liability per article 42 ($[3291 - 600] * 20 \text{ percent} + 89$)	627.20

Example 2

Assume the same facts as in Example 1, but that Sam's monthly income is 209. Sam will compute his 1999 income tax liability as follows.

Total income (209 GEL per month * 12 months)	2508
Total monthly deductions (9 GEL * 12 months)	<u>(108)</u>
Total taxable income	2400
Exemption under article 43(2)(e)	
(209 * 11 months = 2299, subject to 3000 maximum in 1999)	<u>(2299)</u>
Taxable income after exemption	101
Tax liability per article 42 ($101 * 12 \text{ percent}$)	12.12

Assuming Sam continues to receive monthly income of 209 throughout 2000, Sam will compute his 2000 income tax liability as follows.

Total income (209 GEL per month * 12 months)	2508
Total monthly deductions (9 GEL * 12 months)	<u>(108)</u>
Total taxable income	2400
Exemption under article 43(2)(e)	
(209 * 1 month = 209, subject to 3000 maximum in 2000)	<u>(209)</u>
Taxable income after exemption	2191
Tax liability per article 42 ($[2191 - 600] * 20 \text{ percent} + 89$)	407.20

- f. persons who are legal guardians of a child. Unlike e. above, a legal guardian of a child is not limited to the one-year limitation on the exclusion of income.
3. Physical persons (other than those mentioned in part 2 of this instruction) who are classified as Group I or II invalids are exempt from income tax on the first 1500 GEL of taxable income received in a calendar year.

Example

Dato is classified as a Group I invalid. In 1999 he received wages of 350 GEL per month for twelve months. Dato will compute his 1999 tax liability as follows.

<i>Wage income (350 GEL * 12 months)</i>	<i>4200</i>
<i>Exemption per article 43 (maximum)</i>	<i><u>1500</u></i>
<i>Income after exemption</i>	<i>2700</i>
<i>Monthly deduction per article 41 (9 * 8 months)</i>	<i><u>(72)</u></i>
<i>1999 taxable income</i>	<i>2628</i>
<i>1999 tax liability per article 42</i>	
<i>(2618-600) * 20 percent + 89 GEL</i>	<i>492.6</i>

Dato reached his 1500 GEL exemption limitation in May, at which time he had to begin paying income tax on earnings. He may begin taking the 9 GEL monthly deduction beginning in May, and may claim the monthly deduction for the remainder of 1999.

4. Inhabitants of mountainous regions

- a. Inhabitants of mountainous regions who have three and more children are exempt from income tax if their annual income is less than 3000 GEL.
- b. Inhabitants of mountainous regions who have one or two children are allowed a 50 percent reduction in income tax.
- c. The concessions anticipated by Law of Georgia On Social-Economic and Cultural Development of Mountainous Regions will be granted to physical person-entrepreneurs and physical persons anticipated by article 1, part 4 item “f” when the place of income and source of payment is located on the territory of mountainous region. The list of villages subject to this concession are defined by the attachment to the Law of Georgia on Social-Economic and Cultural Development of Mountainous Regions dated 8 June 1999.

5. Exemptions under this article will be reflected as follows.

- a. Physical persons who are paid wages for employment and for whom the tax is calculated and withheld at the source of payment will reflect the exempt amount when wages are received.
 - b. For other taxpayers the exempt amount will be reflected at the filing of the annual income tax declaration.
6. If a physical person loses the right to an exemption specified in this article he/she is required to inform the his/her employer and tax bodies of this within 15 days of the date the annual income tax return is submitted.

Example

Nato is a Group II invalid and is entitled to an exemption under article 43. During 1999 Nato received wages for twelve months of 130 GEL per month. On 1 June 1999 a medical commission concluded that Nato is no longer a Group II invalid. Nato does not meet any other exemption classifications listed in article 43. Nato will compute her 1999 tax liability as follows.

<i>Income received in 1999 (130 GEL * 12 months)</i>	<i>1560</i>
<i>Less amount exempted under article 43</i>	
<i>(130 GEL * 5 months when Group II invalid)</i>	<i>(650)</i>
<i>Taxable income after exemption</i>	<i>910</i>
<i>Monthly deduction per article 41 (9 GEL * 7 months)</i>	<i>(63)</i>
<i>Taxable income</i>	<i>847</i>
<i>1999 tax liability per article 42</i>	
<i>(847-600) * 20 percent + 89</i>	<i>138.40</i>

The monthly deduction provided under article 41 does not apply to months when the only payments received by the taxpayer are exempt from tax under article 43.

Chapter 5. Profit Tax

2.44 Taxpayers

1. Georgian and foreign enterprises as defined in article 13 are subject to profit tax.
2. Enterprises are liable for profit tax on income earned by their branches and other separate units described in article 12(c).

Example

Firm DE is a Georgian enterprise as defined in article 13. DE-B is a branch of DE as defined in article 12(c). During 1999 DE reports taxable income of 300000 GEL. This amount includes 50000 of taxable income from DE-B. In 1999 DE will pay profit tax on the total 300000, while DE-B will not pay tax on the 50000.

3. If a foreign person is not a physical person and it does not prove its joint-ownership consistent with the article 75 of the Tax Code, then for the purposes of this part it is considered an enterprise.

Example

Firm CC is a foreign enterprise as defined in articles 12 and 13 of the Tax Code. CC and Firm GG, a Georgian enterprise, entered into an oral agreement to buy and renovate property located in Georgia. CC and GG did not establish a separate legal enterprise for this activity. CC did not establish its joint ownership under article 75. As a result, CC is considered an enterprise for profit tax purposes.

2.45 Object of Taxation

1. A Georgian enterprise as defined in article 13 is subject to profit tax on worldwide income, which includes income from Georgian and foreign sources. All income, regardless of form, source or place of receipt, is to be included in income unless specifically exempted by the Tax Code. Taxable income is determined by reducing gross income by deductions allowable under the Tax Code.

Example

Georgian Firm YY engages in business in Georgia and Ukraine. During 1999 YY received 222000 income in Georgia and 133000 (GEL equivalent) income in Ukraine. YY's gross profit for Georgia profit tax purposes is 355000. (Refer to article 65 for foreign tax credit rules.)

2. A foreign enterprise as defined in article 13 that engages in economic activity in Georgia through a permanent establishment in Georgia is subject to profit tax on income earned by the permanent establishment in Georgia. Taxable income is determined by reducing gross income earned by the permanent establishment in Georgia by deductions connected to such income that are allowable under the Tax Code.

Example

Firm WW, a Swiss company, is a foreign enterprise as defined in article 13. In 1999 it engaged in economic activity through a permanent establishment in Georgia. In 1999 WW earned 500000 of income outside of Georgia, and earned 25000 of income from its permanent establishment in Georgia. WW's permanent establishment in Georgia incurred 10000 of deductible expenses in Georgia. In 1999 WW will be subject to Georgian profit tax on 15000 GEL (25000 income less 10000 deductions).

3. A foreign enterprise as defined in article 13 that engages in economic activity in Georgia but not through a permanent establishment in Georgia is subject to profit tax on income earned from its economic activity. Income earned by a foreign enterprise from its economic activity in Georgia is not reduced by expenses incurred in generating the income if the income was received from a Georgian source as defined in article 29(18). However, foreign enterprises receiving Georgian source income that is taxed at the source of payment may file a tax declaration in which they can deduct related expenses and obtain a refund of any excess tax withheld. (See article 87(5).) Income earned by a foreign enterprise that is not connected to a permanent establishment is subject to taxation at the source of payment as defined in article 64.

Example

Firm OP, a Swiss company, is a foreign enterprise as defined in article 13. In 1999 it engaged in economic activity in Georgia, but not through a permanent establishment. In 1999 OP earned 50000 of income outside of Georgia, and earned 25000 of income from a Georgian source for its economic activities in Georgia. OP incurred 1000 of expenses connected to its economic activities in Georgia. In 1999 OP will be subject to Georgian profit tax on 25000 GEL. The income will not be reduced by the expenses incurred by OP. The tax will be paid at the source of payment under the rules defined in article 64.

4. Foreign enterprise that receive income from the sale of property defined in part 5 of this article that is not connected with its permanent establishment in Georgia are subject to profit tax on the income received from Georgian sources during the tax year reduced by deductions allowable under the Tax Code that are attributable to the income received.

Example

Firm RR, a German company, is a foreign enterprise as defined in article 13. In 1999 it received income of 20000 on the sale of immovable property located in Georgia that was used in an entrepreneurial activity. RR incurred 2000 of expenses in selling the property. In 1999 RR will be subject to Georgian profit tax on 18000 (20000 income less 2000 deductible expenses).

5. Refer to Tax Code.
6. All forms of income are included in gross income, including but not limited to cash and payments in kind received from economic activity during the tax year.

- a. Examples of forms of income that must be included in gross income are:
- 1) income received from entrepreneurial activity,
 - 2) income received from supply of goods or services,
 - 3) income imputed under article 134(4) resulting from:
 - A) the loss of excise stamps, or
 - B) the failure by importers to import excisable goods within six months from the date of receipt of excise stamps and failure to return the excise stamps to local producers.
 that is not due to force majeure.

Example 1

*Georgian Firm XG produces and bottles sparkling wine. In 1999 XG bought 2500 excise stamps of “d” series and in “g” capacity (liters) to affix to 0.85 liter bottles. In the accounting period XG bottled and delivered 1530 liters of sparkling wine in 0.85 liter bottles, for a total of 1800 bottles (1530 liters / 0.85 bottles). The selling price per bottle was 3.50 GEL. XG used 1800 of the 2500 excise stamps, and the 700 remaining stamps were lost or destroyed. The loss or destruction was not due to force majeure. (See article 134(4) for rules applicable to force majeure.) As a result, 2450 GEL (3.50 GEL sales price per bottle * 700 lost stamps) will be included in the 1999 income reported by XG.*

Example 2

*On April 10, 1999, Georgian Firm MM, an importer of liqueur, bought 1500 excise stamps of “a” series and in “l” capacity (liters) to affix to 0.5 liters bottles of liqueur to be imported. However, MM was unable to import the liqueur for six months, which was not due to force majeure. (See article 134(4) for rules applicable to force majeure.) MM did not return the above mentioned excise stamps. During the six-month period beginning on April 10, 1999, the market price of the “l” capacity (in liters) liqueur was fixed at 3 GEL. The imputed value of the import amounted to 4500 GEL (1500 bottles * 3 GEL per bottle). MM is deemed to have imported 1500 bottles of liqueur inside Georgia. As a result, 4500 GEL will be included in the 1999 income reported by MM.*

- 4) income from the sale of assets used in an entrepreneurial activity;

Example

Georgian Firm ZZ purchased a tractor for 12000 GEL on January 3, 1999. The tractor was purchased for use in ZZ’s entrepreneurial activities. During 1999 ZZ did not own any other assets in this asset group (group 2 per article 54(3)). On December 28, 1999 ZZ sold this tractor for 15000 GEL, resulting in a gain of 3000. In this case 3000 GEL will be included in ZZ’s income from entrepreneurial activities.

- 5) income received from the restriction of entrepreneurial activity or as a result of its dissolution;

Example

In 1999 Georgian Firm SS established an enterprise in Kaheti region that would produce soap. Firm SOP, a soap-producing enterprise, already existed in Kaheti region. SOP offered to pay SS 1000 GEL to not produce soap in 1999. SS accepted SOP's offer and received 1000 GEL in 1999. The 1000 GEL SS received from SOP will be included in SS's 1999 income.

- 6) amounts included in income per article 79;

Example

Georgian Firm NN incurred and deducted business expenses of 500 GEL in 1998. In 1999 NN determined that 100 GEL of these expenses were not deductible. NN will include 100 GEL in income in 1999.

- 7) income from non-entrepreneurial activities, including but not limited to
- A) interest
 - B) dividends
 - C) rent or lease income
 - D) royalties;

Example

*Georgian Firm CC owns a patent on a unique manufacturing process. CC allows Firm LL to use this patent in its production in exchange for 0.15 GEL per good manufactured by LL. In 1999 LL manufactures 10000 goods using this patented process and pays Firm CC 150 GEL ($10000 * .01$ GEL). The 150 GEL CC receives from LL for the use of the patent will be included in Firm CC's income as royalty income.*

- E) income from cancellation of indebtedness; and

Example

In 1999 Georgian Firm WE borrowed 1000 GEL from Firm CR, a customer of WE. Later in 1999 CR forgave 500 GEL of this debt. In 1999 WE will include 500 GEL in income due to cancellation of indebtedness.

- F) gain on the sale of assets not used in entrepreneurial activities.

2.46 Tax Rates

1. The profit of an enterprise is subject to taxation at the rate of 20 percent.
 - a. For enterprises using the cash basis of accounting as defined in articles 69, 70 and 71, profit is determined by reducing income received during the tax year by deductible expenses paid during the tax year.
 - b. For enterprises using the accrual basis of accounting as defined in articles 72, 73 and 74, profit is determined by reducing income earned during the tax year by deductible expenses incurred during the tax year.

Example 1

During 1999 Georgian Firm PO earned 240000 of profit but received only 200000. PO incurred 30000 of deductible expenses, but paid only 22000 during the tax year. PO is a cash basis taxpayer. PO will compute its 1999 profit tax liability as follows.

<i>Income received</i>	<i>200000</i>
<i>Less:</i>	
<i>Deductible expenses paid</i>	<i>(22000)</i>
<i>Profit</i>	<i>178000</i>
<i>Profit tax rate</i>	<i>20 %</i>
<i>Profit tax</i>	<i>35600 GEL</i>

Example 2

Assume the same facts as in Example 1, but Georgian Firm PO is an accrual basis taxpayer. PO will compute its 1999 profit tax liability as follows.

<i>Income earned</i>	<i>240000</i>
<i>Less:</i>	
<i>Deductible expenses incurred</i>	<i>(30000)</i>
<i>Profit</i>	<i>210000</i>
<i>Profit tax rate</i>	<i>20 %</i>
<i>Profit tax</i>	<i>42000 GEL</i>

2. Profit of a foreign enterprise from activity not connected with its permanent establishment is taxed at the rates defined in article 64. (Refer to article 64.)
3. Profit from gas and oil operations carried out according to agreements defined by the Law of Georgia on Gas and Oil are taxed as follows.
 - a. Profit resulting from agreements entered into prior to effective date of the Tax Code of Georgia (July 24, 1997) are taxed at the rate of 10 percent.

Example

On April 2, 1997 Georgian Firm NN entered into an agreement defined in the Law of Georgia on Gas and Oil to conduct gas operations in Georgia. In 1999 NN realized 300000 of profit from this activity. NN will calculate its profit tax from this activity as follows.

<i>Profit</i>	<i>300000</i>
<i>Tax rate</i>	<i><u>10 %</u></i>
<i>Profit Tax</i>	<i>30000 GEL</i>

- b. Profit resulting from agreements entered into on or after the effective date of the Tax Code of Georgia (July 24, 1997) are taxed at the rate in effect on the date the agreement was entered into.

Example

Assume the same facts as in the previous example, but the agreement was entered into on April 2, 1999. NN will calculate its profit tax from this activity as follows.

<i>Profit</i>	<i>300000</i>
<i>Tax rate per article 46</i>	<i><u>20 %</u></i>
<i>Profit Tax</i>	<i>60000 GEL</i>

2.47 Tax Concessions

Refer to the Tax Code for a list of types of enterprises that are exempt from profit tax on specified activities.

Pursuant to article 47(b), charitable organizations (as defined in article 10) are exempt from profit tax, except on profits earned from economic activities (as defined in article 7).

Example

GIVE, a charitable organization under article 10, donates food free of charge to residents of Georgia. GIVE also operates a store in Tbilisi where it sells, rather than donates, kitchen products. GIVE's charitable activity--the donation of food--will not be subject to profit tax. However, its sale of kitchen products will be considered an economic activity under article 7 and GIVE will be subject to profit tax on these activities. Shared expenses must be apportioned between the charitable and economic activities in a manner that results in reasonable allocation of the expenses.

Chapter 6. Deductions and Losses

2.48 Expenses Connected to the Receipt of Income

Expenses connected with the actual or constructive receipt of income may be deductible by the taxpayer to the extent the expenses are:

1. ordinary and necessary in the taxpayer's trade or business;
2. reasonable in amount; and
3. not prohibited under article 49 or other provisions of the Tax Code.

Expenditures of a capital nature are deductible to the extent allowable under the Tax Code.

2.49 Nondeductible Expenses

1. Expenses that are not incurred in connection with economic activity are not deductible.
2. The following rules apply to entertainment and representation expenses.
 - a. Except as provided in 3. below, no deductions are allowed for entertainment expenses.
 - 1) Entertainment expenses are expenses incurred to entertain current or potential customers, including but are not limited to expenses for concerts, performances, athletic events and excursions, and lodging and meals incurred for such activities.
 - b. Provided the requirements for deductibility provided by article 48 and the instructions thereunder are satisfied, representation expenses may be deducted to the extent that the expense does not exceed the norms established by the Ministry of Finance for representation expenses.
 - 1) If no norms have been established by the Ministry of Finance, representation expenses may be deducted to the extent they satisfy the requirements prescribed by article 48 and the instructions thereunder.
 - 2) Representation expenses include, but are not limited to, expenses incurred for conferences, seminars, meetings, visa costs and services, interpreters and translators, transportation, and lodging and meals incurred for such activities.
3. The restriction on the deduction of entertainment expenses provided in subarticle 2. above does not apply to taxpayers whose active economic activity is in the nature of entertainment. Such taxpayers may deduct entertainment expenses that meet the requirements prescribed by article 48 and the instructions thereunder.

Example

Misha owns and operates a bar in Tbilisi. Misha pays a band 100 GEL per night to play in his bar. Misha may deduct the amounts he pays to the band as entertainment expenses, provided the expenses satisfy the requirements of article 48.

4. Deductions are not allowed for expenses incurred by physical persons that are personal in nature and not directly connected to the receipt of employment income.

Example

Natya commutes to her place of employment by metro. She buys her lunch from the cafeteria at her workplace. Natya is not allowed to deduct her commuting expenses or meal expenses from employment income.

5. The amount imputed and included in income under articles 39 or 45 that is due to events described in article 134(4) (loss or damage of purchased excise stamps or inability to import excise goods within the tax year) is deductible to the extent such excise stamps are returned or applied to excisable products during the year.

Example

*On April 10, 1999, Georgian Firm MM, an importer of liqueur, bought 15000 excise stamps of “a” series and in “l” capacity (liters) to affix to 0.5 liters bottles of liqueur to be imported. However, MM was unable to import the liqueur for six months, which was not due to force majeure. MM did not return the above mentioned excise stamps. During the six-month period beginning on April 10, 1999, the market price of the “l” capacity (in liters) liqueur was fixed at 3 GEL. The imputed value of the import amounted to 45000 GEL (15000 bottles * 3 GEL per bottle). MM is deemed to have imported 15000 bottles of liqueur inside Georgia. As a result, 45000 GEL was included in the 1999 income reported by MM.*

*On January 3, 2000 MM imported 7000 bottles of liqueur totaling 21000 GEL (7000 bottles * 3 GEL per bottle). MM applied 7000 of the unused excise stamps it purchased in 1999 to the bottles imported in January 2000. MM will be allowed a deduction in the current year equal to the pro rata share (7000 / 15000) that was imputed and included in income in a previous year. For MM, 21000 GEL $([7000 / 15000] * 45000)$ of the excise stamps will be deductible in the year 2000.*

2.50 Limitation on Interest Deduction

1. Unless otherwise limited under subarticle 2 below, interest expenses on indebtedness is deductible subject to the interest expense determined by applying a maximum interest rate of 150 percent of the inter-bank credit auction rate set by the National Bank of Georgia. The interest rate of the inter-bank credit auction on the day the loan originated must be used for this subarticle.

Example

On January 1, 1999 Georgian Firm FG, a cash basis taxpayer, took out a 1000000 GEL loan from XSA Commercial Bank. The interest rate on the loan was 80 percent per year. On January 1, 1999, when the loan originated, the inter-bank credit auction rate set by the National Bank of Georgia was 50 percent. In 1999 Firm FG may take an interest deduction of 750000 GEL, computed as follows.

<i>Actual interest expense in 1999</i>		
<i>(1000000 GEL * 80 %)</i>		<i>800000</i>
<i>Interest expense deduction in 1999:</i>		
<i>Amount borrowed:</i>	<i>1000000</i>	
<i>50 % (interbank rate)* 150 %</i>	<i><u>* 75 %</u></i>	
<i>Maximum interest deduction allowable</i>		<i>(750000)</i>
<i>Interest disallowed</i>		<i>50000</i>

2. If more than 20 percent of the authorized capital of an enterprise is owned, directly or indirectly, by legal persons who are exempt from profit tax the maximum amount of interest that may be deducted by the enterprise is limited to the aggregate of the enterprises' interest income plus 50 percent of the enterprises' gross income reduced by allowable deductions other than the interest deduction.

Example

In 1999 Georgian Firm TSO received 4000 GEL in interest from treasury obligations. The interest is taxed according to article 63 at the rate of 10 percent. In 1999 TSO had gross income of 48000 GEL and deductions, excluding interest deductions, of 41000 GEL. In 1999 TSO also paid 9000 in interest on its loan obligations.

In 1999 21 percent of the authorized shares of TSO were owned by Firm INV. INV produces technical equipment used for the rehabilitation of invalids. INV is exempt from profit tax under article 47(f). As a result, TSO's interest deduction is limited to the aggregate of its interest income plus 50 percent of its gross income reduced by allowable deductions other than the interest deduction.

In 1999 TSO will compute its interest deduction as follows.

<i>Interest income</i>		<i>4000</i>
<i>Gross income</i>	<i>48000</i>	
<i>Less deductions, excluding interest</i>	<i>(41000)</i>	
	<i>7000</i>	
	<i>50 %</i>	<i>3500</i>
<i>Maximum interest deduction</i>		<i>7500</i>

In 1999 TSO is entitled to deduct 7500 in interest expenses. The remaining 1500 (9000 interest paid – 7500 interest deduction) is not deductible and may not be carried forward and deducted from income in future years.

3. For purposes of this article authorized capital is considered to be owned indirectly by a physical or legal person if it is owned by a related person as defined in article 24.

2.51 Doubtful Debt Deduction

1. A deduction is allowed for doubtful debts if:
 - a. the debt arose from the provision of goods, works, or services from entrepreneurial activity;
 - b. the income for goods, works, or services was previously included in the taxpayer's gross income; and
 - c. the doubtful debt has been written off in the taxpayer's books.
 - 1) Debts that have been fully written off in the taxpayer's books may be deducted in full, provided other requirements imposed by the Tax Code and instructions thereunder have been satisfied.
 - 2) Debts that have been partially written off in the taxpayer's books may be deducted, but only to the extent they have been written off in the taxpayer's books.

This article in the Tax Code is applicable to income and profit taxes but does not apply to value added tax.

2. Doubtful debts (as defined in article 29(29)) will be written off in the taxpayer's books only if the debt is determined to be uncollectible.
3. A deduction for doubtful debts can only be taken by taxpayers who record income and expenses using the accrual method of accounting.

Example

During 1998 Georgian Firm TA performed repair work for Firm DB on a contract basis. TA completed the work required under the contract and charged DB 24000 GEL for the work performed. TA, an accrual basis taxpayer, included the 24000 in the income it reported in 1998, and computed and paid its tax liability based on the inclusion of this amount in income. DB did not pay TA any of the 24000 owed in 1998.

In 1999 DB notified TA the business was being liquidated and that it would be able to pay only 4000 of the 24000 debt. In 1999 DB paid TA 4000 GEL, and TA wrote off the remaining 20000 debt from its books. In 1999 TA is entitled to claim a doubtful debt deduction for 20000 GEL, the amount of the doubtful debt it wrote off. The 4000 GEL payment TA received from DB in 1999 will not be included in 1999 income because it was previously included in income in 1998.

4. Refer to the Tax Code for special rules applicable to banks.

2.52 Deduction for Allocations to Reserve Funds

1. Refer to Tax Code.
2. Refer to Tax Code.

2.53 Deductions for Expenditures on Scientific-Research, Project-Design, and Experimental-Design Work

1. Non-capital expenditures incurred for research, design and development activities that are connected to income earned from such activities are deductible in the year when recorded under the taxpayer's accounting method.
2. Non-capital expenditures incurred for research, design and development activities that are not connected to income earned from such activities are not deductible.
3. Capital expenditures, including but not limited to expenditures for the acquisition and installation of fixed assets, that are incurred for research, design and development activities are not deductible under this article. Such capital expenditures may be capitalized and deducted in accordance with article 54.

Example

Georgian Firm DU is engaged in the business of manufacturing chemical products. On January 1, 1998, DU began work on a special research project intended to develop a new chemical product. On January 1, 1998 DU also purchased a building for 60000 GEL. Fifty percent of the building's facilities were to be used in connection with the special research project. During 1998 DU recorded under its accounting method the following expenditures relating to the special research project.

<i>Wages</i>	<i>15000</i>
<i>Utilities</i>	<i>700</i>
<i>Models/Drawings</i>	<i>8500</i>
<i>Laboratory materials</i>	<i>8000</i>
<i>Attorney's fees</i>	<i><u>1400</u></i>
<i>Total research, design and development expenditures (excluding depreciation) incurred in 1998</i>	<i>33600 GEL</i>
 <i>Depreciation on building attributable to project (50 percent of \$4,200 depreciation allowed per article 54)</i>	 <i>2100</i>

In 1998 DU will deduct 33600 of the expenses incurred in connection with special research project regardless of whether it recorded income related to this project. In addition, under article 54 DU will deduct 2100 of the depreciation expenses related to the special research project, as well as the remaining 2100 in depreciation that is not related to the special project

2.54 Depreciation Charges and Deductions for Fixed Assets

1. Expenditures incurred for the purchase of fixed assets, as defined in article 29(19), used in an economic activity are deductible as depreciation expenses if the requirements of article 54 and the instructions thereunder are satisfied. The depreciation deduction is allowed to provide a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in an economic activity. A depreciation deduction is not allowed to reflect a reduction in market value.
2. Assets that do not qualify for a depreciation deduction include:
 - a. land;
 - b. art (including but not limited to paintings, jewelry and antiques);
 - c. fixed assets transferred to a conservation regime; and
 - d. any other assets that are not subject to wear and tear.
3. Fixed assets subject to depreciation are grouped into asset categories based on the type of asset and depreciated using the rates provided in article 54(3). This method of depreciating assets is termed a “pooling” method because fixed assets are segregated into “pools” or groups”. Depreciation charges are determined for each group rather than for each individual asset within the group.
 - a. Assets included in Groups 1, 2, 3 and 5 are assets “that are depreciated using the group method under Chapter 6” for purposes of articles 82(4) and 84(4).
 - b. Buildings and structures are included in Group 4 but are not aggregated into groups, per article 54(5).
 - c. Assets listed in article 54(2) are not aggregated into groups and are not subject to depreciation.

4. With the exception of buildings and structures defined in subarticle 5 below, asset groups (not individual assets) are depreciated using the balance of the asset group at the end of the tax year. The balance of the asset group is adjusted for purchases, sales and repairs prior to calculating depreciation as provided in subarticle 6 of these instructions.
5. Buildings and structures are not grouped and depreciated together. Each building and structure is depreciated separately based on the rate provided for Group 4 assets.

Example

In 1999 Georgian Firm KC purchased the following for use in its economic activity.

<u>Asset</u>	<u>Cost</u>
Factory	100000 GEL
Office building	70000 GEL
Warehouse	10000 GEL

KC will depreciate each of these assets separately. In 1999 KC will take a 12600 GEL depreciation deduction for these assets, computed as follows.

Factory (100000 GEL * 7 %)	7000
Office building (70000 GEL * 7 %)	4900
Warehouse (10000 GEL * 7 %)	<u>700</u>
1999 depreciation deduction	12600 GEL

6. For depreciation purposes, the year end balance of an asset group is calculated as follows.

Asset Group

Beginning asset balance 1 January (reflecting depreciation and adjustments made in prior years)

Plus:

Assets purchased, per article 81

Excess repair expenses incurred per article 55

Less:

Assets sold, per article 54 subarticle 8

Residual value of the fixed assets transferred to the conservation regime

Ending balance of asset group prior to depreciation

Less:

Depreciation for current year

Ending balance of asset group, 31 December

Example

On December 31, 1998 Georgian Firm GH had a 150000 balance in its Group 2 asset class prior to depreciation. The Group 2 assets and depreciation deduction in 1998 is as follows.

5 lorries	90000
6 tractors	<u>60000</u>
Total Group 2 assets	150000
Depreciation rate	<u>15 %</u>
Depreciation deduction	22500 GEL

In 1999 GH purchased two more tractors for 30000 GEL and sold one lorry for 25000 GEL. GH will compute its Group 2 balance prior to depreciation as follows.

Group 2 January 1, 1999 beginning balance	
(150000-22500 depreciation in 1998)	127500
Purchases (2 tractors)	<u>30000</u>
Total	157500
Less: Assets sold (1 lorry)	<u>(25000)</u>
Group 2 asset balance before depreciation	132500

7. If the amount received upon the sale of fixed assets from a group in the course of a tax year exceeds the asset balance of the group at the end of year the excess is included in gross income and the balance value of the group becomes equal to zero. (See articles 54(7) and 273(1).)

Example

On January 1, 1999 Georgian Firm YY owned 3 computers, which were the only assets in Group 1. The Group 1 balance on this date was 3000 GEL. During 1999 YY sold 2 of the computers for 3300, and did not purchase any other Group 1 assets during the year. On December 31, 1999 YY will report a gain on the sale of the 2 computers of 300 GEL (3300 received less 3000 asset balance). The Group 1 asset balance will be reduced to zero.

8. If the balance of the group at the end of the year is less than 100 GEL the balance will be taken as a depreciation deduction in the current year. (See article 273(1).)

Example

On January 1, 1999 Georgian Firm YY owned 3 computers, which were the only assets in Group 1. The Group 1 balance on this date was 3000 GEL. During 1999 YY sold all of the computers for 2950 GEL, and did not purchase any other Group 1 assets during the year. On December 31, 1999 YY will reflect a balance of 50 GEL in its Group 1 account. Since the account balance is less than 100 GEL, YY will deduct the 50 GEL balance as depreciation expense and maintain a zero balance in its Group 1 account.

9. If all fixed assets of an asset group were sold or liquidated, the balance of the group at the end of the tax year is deducted from gross income. (See article 273(1).)

Example

On January 1, 1999 Georgian Firm YY owned 3 computers, which were the only assets in Group 1. The Group 1 balance on this date was 3000 GEL. During 1999 YY sold all 3 of the computers for 2200, and did not purchase any other Group 1 assets during the year. On December 31, 1999 YY will report a loss on the sale of the 3 computers of 800 GEL (2200 received less 3000 asset balance). The Group 1 asset balance will be reduced to zero.

10. Taxpayers are allowed to use an accelerated depreciation method for asset groups 2 and 3 in article 54(3) of the Tax Code, provided the accelerated depreciation rates used are not more than 2 times the rates specified for these asset groups.
11. Intangible assets are recorded as a separate asset group and are depreciated using the rate in effect for Group 5 assets. (See article 58.)
 - a. No depreciation deduction is allowed for goodwill and other intangible assets that do not have a limited life. See article 58 and instructions thereunder.
 - b. The cost of intangible assets subject to depreciation does not include expenditures incurred for their acquisition or production that have already been deducted by the taxpayer. (See article 58(3).)

2.55 Deduction of Expenses Incurred to Repair Fixed Assets

1. A maximum deduction of 5 percent of the balance of each asset group at the end of the year is permitted for each tax year for repair expenses, provided adequate documentation of the expenses is provided.

Example

*At the end of 1998 and prior to computing the depreciation deduction Georgian Firm PP has a balance in its Group 2 account of 250000 GEL. In 1998 PP claimed repair expenses of 8000 GEL. If PP provides adequate documentation of the repair expenses in 1998 it may deduct the entire 8000 GEL as repair expenses because the amount claimed is less than the maximum repair deduction allowable of 12500 GEL ($250000 * 5$ percent).*

If PP did not provide adequate documentation of the repair expenses it could not claim a deduction for the undocumented repair expenses. The disallowed repair expenses would not be added to the group asset balance.

2. Any repairs incurred that exceed the deduction provided in subarticle 1, above, are added to the balance of the asset group.

- a. Repairs which neither materially add to the value of the asset nor appreciably prolong its life, but rather keep it in an ordinarily efficient operating condition, are considered repairs for purposes of this article.
- b. Repairs in the nature of replacements, to the extent that they slow deterioration and appreciably prolong the life of the property, shall be capitalized and depreciated in accordance with article 54.

Example

*At the end of 1998 and prior to computing the depreciation deduction Georgian Firm GY has a balance in its Group 2 account of 250000 GEL. For this asset group GY may take a deduction for repair expenses in the amount of 12500 GEL ($250000 * 5$ percent). If GY actually incurred 27000 GEL in repair expenses for Group 2 assets the difference between the actual repairs (27000) and the imputed repairs (12500) will be added to the value balance of this group at the end of the tax year, resulting in a value balance of 264500 GEL ($250000 + 14500$) for this asset group. GY will compute its depreciation deduction under article 54 on 264500 GEL.*

2.56 Deduction for Insurance Payments

1. Except for cases specified in subarticle 2 below, insurance premiums paid or incurred by an insured party, including amounts paid for compulsory medical insurance, are deductible to the extent they satisfy the requirements of article 48.

Example

In 1999 Georgian Firm RE paid 35000 GEL in insurance premiums to insure its office building and contents against fire and theft. The premiums are not repayable. The insurance payments will be deductible to the extent they meet the requirements of article 48.

2. Insurance premiums paid or incurred by an insured party are not deductible to the extent they are paid or incurred under an agreement of a cumulative and repayable nature. Insurance payments with respect to an insurance policy that has elements of an investment contract, such as an endowment policy or annuity policy, are not deductible.

2.57 Expenditures on Geological Surveying and Work to Prepare for the Extraction of Natural Resources

1. An enterprise may capitalize and deduct as depreciation expense expenditures incurred for geological surveying and work conducted to prepare for the extraction of natural resources. Such expenditures will be aggregated in a separate asset group and will be depreciated at the rate prescribed for group 2 assets.
2. Expenditures incurred for the acquisition of intangible assets acquired or developed by the taxpayer in connection with rights to geological surveying and processing and the exploration of natural resources may also be capitalized and deducted according to the provisions in subarticle 1. Such expenditures will be included in the same asset class as assets described in subarticle 1.

Per article 273(31), under the law “On Oil and Gas”, expenses incurred for geological survey, spade works for natural resource acquisition and drilling carried out under agreement on share distribution will be deducted in compliance with agreement standards in manner consistent with cost recovery rules.

2.58 Expenditures on Intangible Assets

1. For purposes of article 58, “long periods of time” means more than one year. Intangible assets that are used for more than one year and have a limited useful life include, but are not limited to, copyrights, patents, trademarks and licenses. Although goodwill is an intangible asset, it is excluded from article 58 because it is not considered to have a limited useful life.
2. Expenses incurred to purchase or create intangible assets are to be capitalized and amortized according to the provisions described in article 54 and the instructions thereunder. Intangible assets are depreciated at the rate of depreciation of group 5 fixed assets and shall form a separate group.
3. Refer to Tax Code.
4. Article 58 does not apply to expenditures for intangible assets incurred in connection with the acquisition of rights to geological surveying and processing or exploitation of natural resources. Expenditures for such intangible assets are governed by article 57.

2.59 Limitation on Deduction of Taxes and Fines

No deduction is allowed for:

- a. profit or income taxes paid or payable to Georgia or to other countries.
- b. penalties and fines paid or payable to Georgia or to other countries.

Example

Georgian Firm DD paid the following in 1999.

<i>Georgian profit tax</i>	<i>25000</i>
<i>Ukrainian profit tax</i>	<i>12000</i>
<i>Georgian fines and penalties</i>	<i>300</i>
<i>Ukrainian fines and penalties</i>	<i>900</i>

Firm DD cannot deduct from gross income any of the payments listed above in computing its 1999 tax liability.

2.60 Losses on the Sale of Property

Losses realized by a physical person-entrepreneur on property used in entrepreneurial activities may be deducted to the extent of gains on property realized by the physical person-entrepreneur in the current tax year.

If losses realized from property exceed gains realized from property in the tax year, the excess may be carried forward and be used to offset gains from property during the following five years.

Example

On December 31, 1999 Giorgi, a physical person entrepreneur, sold for 40000 GEL a parcel of land that he used for business purposes. Giorgi had purchased the land in 1998 for 52000. In addition, Giorgi sold a building used in his business for 44000. He had purchased the building in 1999 for 38000. In 1999 Giorgi will compute his gain (loss) from the sale of property as follows.

Land:

<i>Amount realized on sale</i>	<i>40000</i>	
<i>Basis</i>	<i>(52000)</i>	
<i>Loss</i>		<i>(12000)</i>

Building:

<i>Amount realized on sale</i>	<i>44000</i>	
<i>Basis</i>	<i>(38000)</i>	
<i>Gain</i>		<i>6000</i>
<i>Loss carryforward</i>		<i>(6000) GEL</i>

In 1999 Giorgi may offset the 6000 GEL gain from the sale of the building against the 12000 GEL loss from the sale of the land. In the five succeeding tax years (2000-2004) Giorgi may apply the remaining 6000 GEL loss to offset gains from the sale of property until the loss is eliminated.

2.61 Carrying Losses Forward

1. Physical persons who incur losses (defined as deductions stipulated by the Tax Code and instructions thereunder that exceed gross income in a tax year) that are not connected to employment may not deduct such losses from employment income, but may carryforward and deduct such loss from non-wage income for a period of up to five years after the tax year in which the net loss occurred.

Example

In 1998 Rusiko, a Georgian physical person, incurred losses of 2500 from the sale of securities. In 1999 Rusiko earned 2000 from the sale of securities.

Rusiko may deduct the 2000 of the 2500 loss incurred in 1998 from the income from securities earned in 1999. She may carry forward the 500 GEL loss balance and deduct it from non-wage income earned in tax years 2000-2004.

2. Subject to article 61(3) below, legal persons who incur losses (defined as deductions stipulated by the Tax Code and instructions thereunder that exceed gross income in a tax year) may carry forward and deduct such loss from profit for a period of up to five years after the tax year in which the net loss occurred.

Example

Georgian Firm SIO, a legal person, reported the following profit and losses for the tax years 1998-2004.

*1998—loss of 500000 GEL
1999—profit of 150000 GEL
2000—loss of 20000 GEL
2001—loss 50000 GEL
2002—loss of 30000 GEL
2003—profit of 100000 GEL
2004—profit of 150000*

SIO may deduct the 150000 of the 500000 loss incurred in 1998 from the 150000 profit reported in 1999. SIO may deduct 100000 of the 350000 (500000-150000) unused loss incurred in 1998 against the 100000 profit reported in 2003. SIO cannot deduct any of the 250000 balance (500000-150000 - 100000) of the loss incurred in 1998 from profit reported in 2004 because the five-year loss carry forward period has expired.

SIO may deduct 100000 of losses incurred from 2000 to 2002 (20000 + 50000 + 30000) from the 150000 profit reported in 2004.

3. Refer to article 86 and the instructions thereunder for carryforward limitations that may apply in cases involving change of ownership of legal persons.

Chapter 7. Withholding of Tax at the Source of Payment

2.62 Withholding of Tax on Dividends at the Source of Payment

1. Dividends paid by Georgian enterprises to enterprises or physical persons are subject to taxation at the source of payment at the rate of 10 percent.
2. Refer to Tax Code.

Example

*In 1999 Natya received 3000 GEL of dividends from Georgian Firm DF. DF withheld tax of 300 GEL ($3000 * 10$ percent) on the dividends paid. At the end of 1999 Natya will not be subject to income tax on the 3000 GEL of dividends previously taxed at the source of payment.*

3. Georgian enterprises that receive dividends previously taxed at the source of payment in Georgia are entitled to a credit in the amount of tax previously withheld to the extent there exists documentation confirming the payment.

Example

*In 1999 Georgian Firm TY received 3000 GEL of dividends from Georgian Firm DF. DF withheld tax of 300 GEL ($3000 * 10$ percent) on the dividends paid to TY. TY will include the dividends in income in 1999 and will receive a credit of 300 GEL for the taxes previously withheld on the dividends at the source of payment.*

2.63 Withholding of Tax on Interest at the Source of Payment

1. Subject to the exception provided in 2 below, interest paid by a Georgian resident or by or on behalf of a Georgian permanent establishment of a nonresident is taxed at the source of payment at the rate of 10 percent of interest paid from a Georgian source.
2. Interest on credits (loans) paid to resident (as defined in article 29(7)) banks is not subject to taxation at the source of payment.
3. Interest received by a Georgian physical person that was taxed at the source of payment is not subject to further taxation.
4. Resident legal persons whose profit is subject to tax and who receive interest previously taxed at the source of payment in Georgia are entitled to a tax credit in the amount of tax paid to the budget at the source of payment, to the extent there exists documentation confirming the payment.

Example

*In 1999 Georgian Firm OP received 4000 GEL of interest from Georgian Firm DF. DF withheld tax of 400 GEL ($4000 * 10$ percent) on the interest paid to OP. OP will include the interest in income in 1999 and will receive a credit of 400 GEL for the taxes previously paid on the interest at the source of payment.*

2.64 Withholding of Tax on Income of Nonresidents at the Source of Payment

1. Income from a Georgian source that is received by a nonresident and that is not attributable to a permanent establishment of a nonresident located on the territory of Georgia is subject to taxation at the source of payment. Income, without reduction for any deductions, is subject to tax at the following rates:
 - a. dividends – 10 percent;
 - b. interest – 10 percent;
 - c. insurance payments received from Georgian enterprise under agreements covering the insurance or reinsurance of risks – 4 percent;
 - d. payments received from a Georgian enterprise for:
 - 1) telecommunication and transport services in international communications;
 - 2) shipments and transportation of passengers between Georgia and other countries; and
 - 3) profit received by nonresident subcontractors while carrying out gas and oil works according to the Law of Georgia on Oil and Gas – 4 percent;
 - e. payments received from a Georgian enterprise for royalties, management fees, income from performing work or rendering of services, and income stipulated by paragraphs “b”, “i”, “j”, “n” of part 18 of article 29 of the Tax Code -10 percent; and
 - f. wage income received by physical persons according to the rates provided in article 42.

In cases under 1(f) where the payment is subject to a contractual gross-up clause, when the payment includes the tax the payment subject to withholding will be computed as follows:

net payment in lari / 0.9 = amount of payment subject to withholding.

The withheld amount will be equal to the amount of payment subject to withholding times 10 percent.

2. For purpose of this article payments made by or on behalf of a permanent establishment are considered to be made by a Georgian enterprise.
3. A legal or physical person who pays income to a non-resident that does not have a permanent establishment on the territory of Georgia shall submit information on the amount paid and tax withheld to the appropriate tax agency within one month following the date of payment.
4. A non-resident taxpayer who does not have a permanent establishment in Georgia and receives income defined in 64(1)(c), (d) and (e) of this article that is taxed at the source of payment may submit a tax return and receive a refund of the tax withheld. The tax return must be submitted within the time period defined by article 87 and any extensions of time granted. The non-resident taxpayer who submits a tax return will be taxed as if the income received was connected to the permanent establishment of a taxpayer in Georgia. Expenses connected to such income are deducted using the same procedure established for taxpayers who maintain a permanent establishment. The tax

liability computed on the return is limited to the amount of tax paid at the source of payment.

Example

On July 31, 1998 Firm IN, a non-resident taxpayer that does not maintain a permanent establishment in Georgia, received 100000 GEL from a Georgian enterprise TR for the lease of equipment located in Georgia. According to the article 64(e) Firm TR must withhold and remit to the budget 10 percent, or 10000 GEL, of the payment and transfer this amount to the budget, and pay the balance of 90000 GEL to IN. IN incurred expenses of 25000 GEL in connection with the equipment rented in Georgia.

5. Refer to article 87(5) for provisions permitting a nonresident taxpayer without a permanent establishment in Georgia to who receives income stipulated in articles 64(1)(c), (d) and (e) to be taxed as if this income was connected to a permanent establishment in Georgia. The expenses of the taxpayer incurred in connection with such income are deductible under the provisions governing permanent establishments, provided that the tax shall not exceed the amount of tax withheld at the source of payment as stipulated by article 64.

Example

Firm GER, a nonresident taxpayer, is located in Germany. In 1999 it is entitled to receive 100000 GEL from Georgian Firm LZ for the lease of equipment in Georgia to LZ. Under article 64(e), LZ is required to withhold 10000 GEL (10 percent) from the 100000 payment to GER. In 1999 LZ paid GER 90000 GEL and remitted 10000 GEL to the State budget. In 1999 GER incurred 60000 GEL in allowable expenses for the lease of equipment to LZ.

GER may elect to file a profit tax return (due prior to April 1, 2000) in Georgia. On its return GER would compute its tax liability as follows.

<i>Lease income</i>	<i>100000</i>
<i>Less: allowable deductions</i>	<i><u>(60000)</u></i>
<i>Taxable profit</i>	<i>40000</i>
<i>Tax rate per article 46(1)</i>	<i><u>20 %</u></i>
<i>Tax liability</i>	<i>8000</i>
<i>Less: Tax withheld at source</i>	<i><u>(10000)</u></i>
<i>Amount of overpayment</i>	<i>2000</i>

In this case the tax withheld at the source of payments (10000 GEL) exceeds GER's tax liability per the tax return (8000 GEL), so GER is entitled to a 2000 GEL tax refund.

If GER's tax liability per its return exceeded the tax withheld at the source of payments, GER would not be liable for the additional amount of tax.

IN may submit a 1998 tax return in Georgia prior to April 1, 1999 (plus any additional extensions granted). If IN submits a tax return in Georgia it will state the following.

<i>Income from rental</i>	<i>100000</i>
<i>Less: Expenses connected to rental income</i>	<i>(25000)</i>
<i>Taxable Profit</i>	<i>75000</i>
<i>Tax (per article 46(1) rates)</i>	<i>15000</i>

The tax liability on the return is limited by the amount of tax withheld at the source of payment, or 10000 GEL. Therefore, IN's 1998 tax liability is 10000 GEL.

Example 2

Assume the same facts as in Example 1, but that IN incurred IN expenses of 60000 GEL in connection with the equipment rented in Georgia.

IN may submit a 1998 tax return in Georgia prior to April 1, 1999 (plus any additional extensions granted). If IN submits a tax return in Georgia it will state the following.

<i>Income from rental</i>	<i>100000</i>
<i>Less: Expenses connected to rental income</i>	<i>(60000)</i>
<i>Taxable Profit</i>	<i>40000</i>
<i>Tax (per article 46(1) rates)</i>	<i>8000</i>

Since IN paid tax of 10000 at the source of payment, IN is entitled to a refund of 2000 (10000 - 8000).

6. If procedures governing the taxation of profit are established by international agreement and Georgia is a party to the agreement, such procedures will apply.
 - a. In cases where the income received in Georgia by a non-resident physical person or foreign enterprise is subject to preferential tax treatment or exemption according to an international agreement, the taxpayer or tax agent may submit a statement to the appropriate tax agency describing the preferential tax or exemption with a claim for a refund.
 - b. Based on the statement submitted by the taxpayer all or a portion of the tax previously paid may be refunded by the Georgian tax agency.

Chapter 8. International Taxation

2.65 Foreign Tax Credit

1. Amounts of income tax or profit tax paid outside Georgia with respect to income or profit subject to tax in Georgia are credited upon payment of tax in Georgia if evidence of payment is provided.
2. The amount of the credit stipulated by article 65(1) must not exceed the amount of tax charged in Georgia on that income at the rates in effect in Georgia.

Example

*In 1998 Georgian Firm RX had taxable profit of 200000 (GEL equivalent) in Croatia, and paid profit tax in Croatia of 60000 (GEL equivalent) (200000 * 30 percent tax rate). Firm RX included this profit in its 1998 Georgian profit tax return. Firm RX reported taxable profit of 700000 GEL on its Georgian profit tax return. RX will compute its 1998 tax liability as follows.*

<i>Taxable Profit (including 200000 earned in Croatia)</i>	<i>700000</i>
<i>Tax (per article 46) (700000 * 20 percent)</i>	<i>140000</i>
<i>Less: Credit for tax paid in Croatia, limited by tax rate</i>	
<i> applied in Georgia (200000 * 20 percent)</i>	<i><u>(40000)</u></i>
<i>1998 Georgian tax liability</i>	<i>100000</i>

Firm RX is not entitled to a credit for 20000 of the 60000 GEL equivalent it paid in taxes in Croatia because this represents the excess of the Croatian tax rate (30 percent) less the tax rate applied in Georgia (20 percent).

2.66 Income Received in Countries with Preferential Taxation

1. If a resident

- directly or indirectly owns more than 10 percent of the authorized capital of a foreign enterprise that earns income from a country with preferential taxation system, or
- has more than 10 percent of the voting shares of a legal person that earns income from a country with preferential taxation system,

then the resident must include in taxable income his share of income of the foreign enterprise or legal person.

For purposes of this article:

- a. “Resident” is defined under article 29(7), and can include either a legal person or a physical person;
 - b. A resident “directly” owns authorized capital of a foreign enterprise or voting shares if it has legal title to such capital or shares.
 - c. A resident “indirectly” owns authorized capital of a foreign enterprise or voting shares if it has a direct ownership interest in a separate legal person, and that separate legal person directly or through a chain of ownership of subsequent legal persons has an ownership interest in all or a portion of the authorized capital or voting shares a foreign enterprise.
2. A foreign state is considered a “state with concessional taxes” if:
- a. the tax rate in the state is 13.33 percent or lower ($1/3$ lower than the maximum tax rate (20 percent) imposed by the Tax Code of Georgia); or
 - b. the state has in effect laws on confidentiality of financial information that guarantee secrecy to be maintained concerning the actual owner of property or income.

Example 1

*Georgian enterprise RE owns 40 percent of Bahamian enterprise BA. In 1999 BA had profit of 100000 (GEL equivalent). The profit tax rate in the Bahamas is 5 percent. The Bahamas is considered a state with preferential taxation under article 66(2) because the profit tax rate (5 percent) is more than $1/3$ lower than the 20 percent profit tax rate in effect in Georgia ($20 \text{ percent} * 1/3 = 13.33\%$, that is more than 5%). In 1999 RE will include in taxable the following amount from BA.*

<i>BA profit in Bahamas</i>	<i>100000</i>
<i>RE ownership of BA</i>	<i><u>40 %</u></i>
<i>RE share of BA profit included in income</i>	<i>40000</i>

Example 2

Georgian enterprise EK owns 25 percent of Panamanian enterprise PA. In 1999 PA had profit of 200000 (GEL equivalent). The profit tax rate in the Panama 25 percent. Confidentiality laws on financial information exist in

Panama. Therefore, under article 66(2) Panama is considered a state with preferential taxation for Georgian tax purposes. In 1999 EK will include in taxable the following amount from PA.

<i>PA profit in Panama</i>	<i>200000</i>
<i>EK ownership of PA</i>	<i>25 %</i>
<i>EK share of PA profit included in income</i>	<i>50000</i>

Example 3

In 1999 Georgian Firm GTR owned an 8 percent interest in Chilean Firm CHIL. In 1999 CHIL had profit of 100000 (GEL equivalent). The profit tax rate in the Chile is 6 percent and confidentiality laws on financial information exist in Chile. Even though under article 66(2) Chile is considered a state with preferential taxation, for Georgian tax purposes GTR will not include in income its share of CHIL's profits because GTR did not own more than 10 percent of the authorized capital or voting shares of CHIL.

Chapter 9. Tax Accounting Rules

2.67 Tax Year

All taxpayers will use a calendar year, defined as 1 January through 31 December, as their tax year.

2.68 Principles for Recording Income and Expenditures

1. Refer to Tax Code.
2. Refer to Tax Code.
3. Taxable income must be determined using the same method (cash or accrual) that the taxpayer uses for accounting purposes. If the taxpayer is required to use the accrual method under International Accounting Standards (IAS), then the taxpayer must also use the accrual method for computing taxable income. Any differences between tax and accounting income will be reflected in adjustments made when converting accounting income to taxable income.

Example

In 1999 Georgian Firm QW purchased a computer for 2000 GEL for use in its business. Under its accounting method QW deducted 25 percent, or 500 GEL, as a depreciation expense. Under article 54(3) of the Tax Code QW is entitled to a depreciation deduction of 400 for the computer. It is not entitled to use an accelerated depreciation method because the computer is a Group 1 asset, and article 54(10) only allows accelerated depreciation for Group 2 and 3 assets. Therefore, in computing its 1999 tax liability QW depreciation deduction is limited to 400 GEL.

4. A taxpayer must use the same accounting method (cash or accrual) throughout the tax year.
5. Article 73(1) provides the general rule that under the accrual method of accounting income is recorded if the income is subject to payment or if the taxpayer has fulfilled all obligations under the transaction (agreement). This subarticle modifies the general rule by providing that the moment of receipt of income shall be deemed to be the period following 90 days from the moment of supply of goods, fulfillment of work, or rendering of services, but if the payment is made prior to that period then the moment of payment is deemed to be the moment of receipt.
 - a. The rule stated in this subarticle does not affect the recording of expenditures under the accrual method.
 - b. The rule stated in this subarticle applies even though it is not applicable under IAS. Taxpayers using IAS must provide an adjustment when converting from accounting to taxable income.
 - c. The rule stated in this subarticle does not apply to cash basis taxpayers.

Example

On April 1, 1999 Georgian Firm UU, an accrual basis taxpayer, provided accounting services to Fran totaling 200 GEL. On the same day UU provided accounting services to Peter totaling 150 GEL for accounting services. Fran paid 200 GEL to UU on May 15, while Peter paid 150 GEL to UU on November 1.

Under the accrual method the income for services performed for Fran will be recognized on May 15, the date of actual receipt of 200 GEL by UU, because the payment was made within 90 days of when the services were performed. The income for services performed for Peter will be deemed June 29 (90 days from when services were performed) because payment was not received within 90 days of when the services were performed.

6. Refer to Tax Code.

Example

Zura, a Georgian resident, earned 100 GEL per month from Georgian Firm PP, his principal place of employment. From January through April 1999 Zura earned 400 GEL, but received only 200 GEL in April. Zura will include the 200 GEL in wage income when received (April), and will not include his earned but unpaid wage income.

In addition, Zura earned but did not receive income of 40 GEL in April from an entrepreneurial activity. Zura uses the accrual method to report income from his entrepreneurial activity. In April Zura will report 40 GEL from his entrepreneurial activity.

7. Refer to Tax Code.

All income and expenses conducted in a currency other than GEL must be converted into GEL on the date the income or expenses is recognized using the exchange rate of the National Bank of Georgia for that date.

2.69 Recording Income and Expenditures Using the Cash Basis Method

Refer to Tax Code.

Example

In 1999 Maia, a cash basis taxpayer, earned 150000 GEL for translating services performed in 1999, and received payments for these services totalling 90000 GEL. In 1999 Maia incurred expenses of 40,000, of which she paid 30000 GEL. Maia will compute her 1999 taxable income as follows.

<i>Income received</i>	<i>90000</i>
<i>Less: Expenses paid</i>	<i><u>(30000)</u></i>
<i>Taxable Income</i>	<i>60000 GEL</i>

2.70 Moment of Receipt of Income when using the Cash Basis Method

1. Non-cash payments refer to payments readily convertible to cash, such as checks, bank transfers or letters of credit. It does not, however, refer to promissory notes, which are described in subarticle 3 below, nor to non-monetary payments.

Example

Manana, a physical person, is a cash basis taxpayer. On January 1, 1998 Manana performed accounting services for Firm UI. In payment for these services UI transferred 1000 GEL to Manana's bank account on July 1, 1998. Manana will include the 1000 GEL in income on July 1, 1998, the date of the bank transfer.

2. Refer to Tax Code.

3. Refer to Tax Code.

Example

Marina, a physical person, is a cash basis taxpayer. On January 1, 1998 Marina performed catering services for Firm UI. In payment for the services UI gave Marina a promissory note in the amount of 1000 GEL, due on June 1, 1998. Marina will include the 1000 GEL in income on June 1, 1998, the due date of the promissory note.

Example 2

Assume the same facts as in Example 1, but that Marina sells UI's promissory note on April 1, 1998 for 960 GEL. Marina will include 960 GEL in income on April 1, 1998, the date she sold the promissory note.

2.71 Moment of Carrying out of Expenditures When Using the Cash Basis Method

1. Refer to Tax Code.
2. Refer to Tax Code.
3. Refer to Tax Code.
4. Payment in non-monetary form includes payments for services that are not in the cash or non-cash form as provided in article 70(1).
 - a. If the value of the services performed is stated it is considered the amount of the expenditure.
 - b. If the value of the services is unstated or is unclear, the value of the non-monetary payment is considered to be the amount of the expenditure.

Example 1

On April 1, 1998 Giorgi rendered legal services to Tamuna. The agreed-upon value of the services was 100 GEL. In lieu of cash Tamuna offered to give Giorgi a television. Giorgi accepted the television and agreed that its value was 100 GEL. Tamuna will recognize an expenditure in the amount of 100 GEL on the date it transferred the television set to Tamuna, and Giorgi will include 100 GEL in income on the date he took possession of the television.

Example 2

Assume the same facts as in Example 1, but that no value was placed on the services Tamuna provided. Rather, Giorgi simply offered to transfer the television set to Tamuna in exchange for her legal services. The fair market value of the television set on the date of transfer will be reflected as an expense to Giorgi and will be included in Tamuna's income.

5. Refer to Tax Code.

Example

*On March 1, 1998 Khatuna agreed to provide a Dmitry, a cash basis taxpayer, a loan of 500 GEL with a 6 percent simple rate of interest. The loan agreement stated that the principal (500 GEL) plus interest (15 GEL) totaling 515 GEL is to be paid on February 1, 1999. In this case the interest income is earned over two tax years, 1998 and 1999. Even though Dmitry uses the cash method he must report interest expenses of 10 GEL (2.5 GEL * 4 months) in 1998. Dmitry will report the remaining 5 GEL (2.5 GEL * 2 months) of interest expenses in 1999.*

2.72 Recording Income and Expenditures Using the Accrual Basis Method

Refer to Tax Code.

Example

In July 1999 Georgian Firm IU, an accrual basis taxpayer, earned and had the right to receive 150000 GEL for services performed in 1999, and received payments for services totaling 90000 GEL. In July 1999 IU also incurred expenses of 40,000, of which it paid 30000 GEL. IU will compute its 1999 taxable profit as follows.

<i>Income earned</i>	<i>150000</i>
<i>Less: Expenses incurred</i>	<i><u>(40000)</u></i>
<i>Taxable Profit</i>	<i>90000 GEL</i>

2.73 Moment of Receipt of Income When using the Accrual Basis Method

1. Refer to Tax Code and to article 68 and the instructions thereunder.
2. Refer to Tax Code to article 68 and the instructions thereunder.

Example 1

On March 1, 1998 Khatuna, an accrual basis taxpayer, agreed to provide Dmitry goods valued at 1000 GEL. Khatuna agreed to pack the goods, and required 3 additional days for packing. Dmitry agreed to pick up the goods on March 4. Khatuna obtain the right to receive 1000 GEL on March 4, the date she satisfied her duties. Therefore, the 90-day period prescribed in article 68(5) will begin to run on March 5, 1998, the day after the act was completed (according to article 220 of the Tax Code).

Khatuna will include the 1000 GEL in income on June 2, 1998, (90 days after the transaction was completed), provided she does not receive payment before this date.

Example 2

On May 1, 1998 Katy, an accrual basis taxpayer, agreed to paint Dato's house for 800 GEL, including materials. Katy agreed to finish painting Dato's house on or before May 20, 1998. However, due to bad weather Katy did not finish painting Dato's house until June 1, 1998.

Katy acquires the right to receive the 800 GEL on June 1, 1998, the date she completed the services (painting Dato's house) required to be performed under the agreement. The 90-day period prescribed in article 68(5) will begin to run on June 2, 1998, the day after the services were completed (according to article 220 of the Tax Code).

Katy will include the 800 GEL in income on August 30, 1998, (90 days after the transaction was completed), provided she does not receive payment before this date.

3. Refer to Tax Code. The 90-day provision contained in article 68(5) does not apply to interest or rental income.

Example 1

On March 1, 1998 Khatuna, an accrual basis taxpayer, agreed to provide a Dmitry a loan of 500 GEL with a 6 percent simple rate of interest. The loan agreement stated that the principal (500 GEL) plus interest (15 GEL) totaling 515 GEL is to be paid on September 1, 1998. Khatuna will obtain the right to receive 515 GEL on September 1, 1998, the date the loan is due.

Under article 73(3) Khatuna's right to receive income in the form of interest is considered to be acquired at the expiration of the term of the debt obligation. Therefore, the moment of receipt is considered to be September 1, 1998. Khatuna will record 15 GEL of interest income on this date, regardless of whether or not she received this amount. The 90-day period prescribed in article 68(5) does not apply here because it does not apply to interest or rental income.

Example 2

*Assume the same facts as in Example 1, but that the loan originated on September 1, 1998 and is to be repaid on February 1, 1999. In this case the interest income is earned over two tax years, 1998 and 1999. Therefore, Khatuna must include the 10 GEL (2.5 GEL * 4 months) interest accrued in 1998 in her 1998 income. The remaining 5 GEL (2.5 GEL * 2 months) of interest earned in 1999 will be included in Khatuna's 1999 income.*

2.74 Moment of Carrying out Expenditures when using the Accrual Basis Method

1. Refer to Tax Code.
2. Refer to Tax Code.
3. Refer to Tax Code.

2.75 Joint Ownership

1. The article provides the general rule when a joint ownership arrangement is established between two or more persons without the establishment of a separate legal person. The owners can be either legal or physical persons. Refer to the Civil Code of Georgia of descriptions of the types of joint ownership arrangements.
2. In such joint ownership arrangements income and deductions resulting from the joint ownership arrangement are attributed and taxed to the owners according to their ownership interests.

Example 1

In 1999 Georgian residents David and Amiran entered into a joint ownership arrangement as defined in article 75. Under the arrangement David and Amiran rented a farm and proceeded to raise cattle for future sale. David and Amiran did not establish a legal person for this activity. According to the agreement David contributed 60 percent of the funds needed to conduct the activities specified by the joint ownership arrangement, and Amiran contributed 40 percent. Their ownership interests were based on the funds provided (60% / 40%). Accordingly, profit and losses are allocated 60 percent to David and 40 percent. In 1999 the joint ownership arrangement produced the following:

	<i>Total</i>	<i>David</i>	<i>Amiran</i>
<i>Gross income</i>	10000	6000	4000
<i>Deductible expenses</i>	(4000)	(2400)	(1600)
<i>Total</i>	6000	3600	2400

In 1999 David and Amiran will include their respective income and deductions given above in their individual income computations

Example 2

In 1999 AA, an engineering company in the United States, and GE, a German construction company, enter into an equal joint ownership arrangement to build a pipeline in Georgia. No separate legal person was formed for this activity. GE has a permanent establishment in Georgia, while AA does not.

Under article 75, income and deductions resulting from the construction of the pipeline will be allocated equally to AA and GE based on their ownership interests. AA will be taxed as a foreign enterprise with a permanent establishment in Georgia, while AA will be taxed as a foreign enterprise with no

permanent establishment in Georgia.

Example 3

In 2000 Georgian residents Ketti, Levan and Ivan entered into a joint ownership arrangement as defined in article 75. Under the arrangement Ketti contributed a building with a fair market value of 20000 GEL, Levan contributed office furniture and computers with a fair market value of 10000, and Ivan contributed 10000 GEL. Ketti, Levan and Ivan wrote and sold computer software programs. They did not establish a legal person for this activity. According to their agreement ownership interests were based on the assets provided. Accordingly, profit and losses are allocated 50 percent to Ketti, 25 percent to Levan and 25 percent to Ivan. In 2000 the joint ownership arrangement produced the following.

	<i>Total</i>	<i>Ketti</i>	<i>Levan</i>	<i>Ivan</i>
<i>Gross income</i>	40000	20000	10000	10000
<i>Deductible expenses</i>	<u>(12000)</u>	<u>(6000)</u>	<u>(3000)</u>	<u>(3000)</u>
<i>Total</i>	28000	14000	7000	7000

In 2000 Ketti, Levan and Ivan will include their respective income and deductions given above in their individual income computations

2.76 Recording Income and Deductions under Long-Term Contracts

1. Taxpayers using the accrual method of accounting (but not the cash method) are required to record income and deductions resulting from long-term contracts (as defined in article 76(3)) based on the percentage of completion of the contract.
2. The percentage completion of the contract is determined by dividing the expenses incurred under the contract in the tax year by the total expenditures projected under the contract.
3. Refer to Tax Code for the definition of “long-term contract”.

Example 1

Georgian Firm GH uses the accrual method of accounting. In January 1998 GH contracted to construct a garage for Firm TT. The total payment under the contract is 18000 GEL. The construction is expected to take one month to complete. GH is scheduled to start construction on September 1, 1998. According to GH’s calculations the construction costs will total 16500 GEL. Therefore, GH forecasts a profit of 1500 GEL.

GH commenced construction on September 1, 1998. As of December 31, 1998, construction of the garage had not been completed. In 1998 GH expended 9900 GEL on the construction of the garage.

Because this contract was estimated to be completed within one month of commencement of the work it is not considered a “long-term contract” under article 76. As a result, the percentage of completion method allowed under article 76 is not applicable, and GH will record its income and deductions from this contract using accrual rules described in articles 72 to 74.

Example 2

Georgian Firm GH uses the accrual method of accounting. In January 1998 GH contracted to construct a garage for Firm TT. The total payment under the contract is 18000 GEL. The construction is expected to take seven months to complete. GH is scheduled to start construction on September 1, 1998. According to GH’s calculations the construction costs will total 16500 GEL. Therefore, GH forecasts a profit of 1500 GEL.

GH commenced construction on September 1, 1998. As of December 31, 1998, a portion of the construction of the garage had been completed. In 1998 GH expended 9900 GEL on the construction of the garage.

Because this contract is considered a “long-term contract” under article 76(3) of the Tax Code the percentage of completion method provided in article 76 will be used to determine income and expenses related to the contract. In 1998 GH will report income and expenses calculated as follows.

<i>Income</i>		
<i>Projected income (contract amount)</i>	<i>18000</i>	
<i>Percentage completion</i>		
<i>(9900 expenses incurred to date/</i>		
<i>16500 projected total expenses</i>	<i><u>60 %</u></i>	
<i>Income reported in 1998</i>		<i>10800</i>
<i>Less: Expenses incurred to date</i>		<i><u>(9900)</u></i>
<i>Net Profit for 1998 under percentage of</i>		
<i>completion method</i>		<i>900 GEL</i>

The 90-day rule for accrual accounting provided in article 68(5) does not apply to income and deductions reported under long-term contracts.

2.77 Procedure for Recording Stocks of Commodities and Materials

1. A taxpayer must include in commodity and material stocks (inventory) the cost (as determined in subarticle 3, below) of any processed or partially processed goods that it owns, regardless of location, which are used in computing taxable income.
 - a. “Goods” includes, but is not limited to, raw materials and materials acquired for subsequent sale or for production of goods, fulfillment of work, or rendering of services.
 - b. “Ownership” includes goods and materials that the taxpayer has title to, but does not include goods and materials that are merely in the taxpayer’s possession, including but not limited to goods held on consignment.
2. In determining the effect of inventory on taxable income the following formula is applied.

Revenue
 Minus: beginning inventory
 Minus: purchases
 Plus: ending inventory
 Equals income

Example

In 1998 Georgian Firm TIM began conducting an economic activity. In 1998 TIM reported the following amounts.

<i>Purchase of goods for resale</i>	<i>10000</i>
<i>Sales (exclusive of VAT)</i>	<i>2000</i>
<i>Beginning inventory</i>	<i>0</i>

TIM reported sales of 3000 GEL in 1999 and 12000 GEL in year 2000. It did not purchase any goods for resale in 1999 or 2000. Ending inventories for each year are provided below.

TIM will report taxable income in 1998, 1999 and 2000 as follows.

	<u>1998</u>	<u>1999</u>	<u>2000</u>
<i>Revenues (sales) (exclusive of VAT)</i>	<i>2000</i>	<i>3000</i>	<i>12000</i>
<i>Plus: ending inventory</i>	<i>8500</i>	<i>6500</i>	<i>0</i>
<i>Minus: beginning inventory</i>	<i>(0)</i>	<i>(8500)</i>	<i>(6500)</i>
<i>Minus: purchases</i>	<i>(10000)</i>	<i>(0)</i>	<i>(0)</i>
<i>Equals taxable income</i>	<i>500</i>	<i>1000</i>	<i>5500</i>
<i>Tax (20 % per article 46)</i>	<i>100</i>	<i>200</i>	<i>1100</i>

3. Refer to Tax Code on how to compute the cost of items included in inventory.

Example

Georgian Firm JJ produces bottles. JJ receives the raw materials used in producing the bottles from different sources. In 1999 JJ paid the following.

<i>Raw materials (glass) purchased</i>	<i>1500</i>
<i>Plus: Transportation costs of materials</i>	<i>100</i>
<i>Storage of materials (including allocable portion of depreciation, property taxes, security, insurance, and other expenses)</i>	<i>75</i>
<i>Total cost/value of raw materials</i>	<i>1675 GEL</i>

4. Items in inventory that are defective, obsolete, out of fashion, or for other reasons have a value less than their production or acquisition costs may be valued at their market price, as provided in article 27. In the absence of specific valuation methods reasonable estimates of valuation may be made by the taxpayer.

Example

Georgian Firm JJ produces bottles. In January 1999 JJ manufactured 1000 bottles at a total cost of 600 GEL, or 0.6 GEL/bottle. JJ damage 100 of the bottles during delivery. The damaged bottles are of no value. JJ will value the 100 damaged bottles at 0 GEL.

5. Allocating costs (described in article 77(3)) to individual items (referred to as “specific identification”) is often an appropriate inventory valuation method to use when the taxpayer produces or purchases for resale few goods or has goods in inventory that are not interchangeable. The specific identification method is less appropriate (due in part to the cost of maintaining records for each asset) when the taxpayer produces or acquires many goods that are interchangeable. A taxpayer who does not use the specific identification method may use any of the inventory methods allowed in this subarticle.
- a. The FIFO (first in, first out) inventory method assumes that goods that were produced or purchased first are sold or transferred first. As a result, the goods produced or purchased last are assumed to remain in inventory.

Example

Georgian Firm JJ produces bottles. No special identification of the produced goods is needed in order to determine the value of commodities and materials so JJ does not record expenses incurred to produce specific bottles. As of January 1, 1999 JJ has 1000 bottles that cost 500 GEL (0.5 GEL per bottle) to manufacture. In January JJ manufactured an additional 1000 bottles at a cost of 600 GEL (0.6 GEL per bottle). In January JJ sold 1200 bottles for 1 GEL/bottle.

Using the FIFO inventory method JJ will compute cost of goods sold as:

1000 bottles at 0.5 GEL/bottle	500 GEL
200 bottles at 0.6 GEL/bottle	<u>120 GEL</u>
Cost of 1200 bottles sold	620 GEL

JJ will compute its profit as follows.

Sales (1200 bottles * 1 GEL)	1200
Cost of goods sold (FIFO method)	<u>(620)</u>
Profit	580 GEL

The cost of the inventory remaining will be 480 GEL (800 bottles * 0.6 GEL).

- b. The LIFO (last in, first out) inventory method assumes that goods that were produced or purchased last are sold or transferred first. As a result, the goods produced or purchased earlier are assumed to remain in inventory.

Example

Assume the same facts as in the example above, but that JJ uses the LIFO inventory method.

Using the LIFO inventory method JJ will compute cost of goods sold as follows.

1000 bottles at 0.6 GEL/bottle	600 GEL
200 bottles at 0.5 GEL/bottle	<u>100 GEL</u>
Cost of 1200 bottles sold	700 GEL

JJ will compute its profit as follows.

Sales (1200 bottles * 1 GEL)	1200
Cost of goods sold (LIFO method)	<u>(700)</u>
Profit	500 GEL

The cost of the inventory remaining will be 400 GEL (800 bottles * 0.5 GEL).

- c. Under the average cost inventory method, the average cost of goods in beginning inventory and similar goods purchased or produced during the period is determined. The average cost may be calculated on a periodic basis or when additional similar goods are produced or purchased. The average cost per good will apply to goods sold as well as to goods that remain in inventory.

Example

Assume the same facts as in the example above, but that JJ used the average cost method for inventory purposes.

Using the average cost inventory method JJ will compute cost of goods sold as follows.

1000 bottles at 0.5 GEL/bottle	500 GEL
1000 bottles at 0.6 GEL/bottle	<u>600 GEL</u>
Cost of 2000 bottles	1100 GEL
Average cost per bottle (1100 GEL / 2000 bottles)	0.55 GEL
Bottles sold	<u>* 1200</u>
Cost of 1200 bottles sold	660 GEL

JJ will compute its profit as follows.

Sales (1200 bottles * 1 GEL)	1200
Cost of goods sold (average method)	<u>(660)</u>
Profit	540 GEL

The cost of the inventory remaining will be 440 GEL (800 bottles * 0.55 GEL).

2.78 Leasing (Financial Rental)

1. A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time for an agreed amount. A finance lease is a lease that transfers substantially all of the risks and rewards incident to ownership from the lessor to the lessee.
 - a. Title may or may not be transferred under a finance lease.
 - b. If the lease is considered a finance lease under article 78(2) the lessee is considered the possessor of the leased asset.
 - 1) The lessor must record the assets it leases under a finance lease in its balance sheet as a receivable in an amount equal to the net amount (including repayments of principal and interest income) to be received under the lease.
 - 2) The lessee must record the leased asset at the fair market value of the asset on the date the lease originated, and may depreciate the asset as provided under article 54. Lease payments should be apportioned between repayment of principal and finance charges. The total finance charges under the lease should be allocated throughout the lease term using a constant rate of interest.
2. Refer to Tax Code for leases that are considered to be finance leases.

3. A “lease term” is considered to include any period for which the lessee has the right to extend the lease.

Example

Georgian Firm OR agrees to lease a building to Georgian Firm EE for 5 years, and gives EE the right to lease the building for an additional two successive 5-year terms. Pursuant to article 78(2), the lease term is considered to be 15 years. The period of service of the building is 14.29 years (7 percent depreciation level for Group 4 assets as provided article 54(3) equates to 14.29 years). Eighty percent of the period of service for the building is 11.43 years (14.29×80 percent).

Since the lease term (15 years) exceeds 80 percent of the period of service for the building (11.43 years), the lease is considered a finance lease under article 78(2). As a result, OR will report this in its balance sheet as a receivable in an amount equal to the net amount (including repayments of principal and interest income) to be received under the lease, and will not include the building in its balance sheet. EE will include the building in its balance sheet at the fair market value of the building on the date the lease originated, and may depreciate the building as provided under article 54. Lease payments made by EE should be apportioned between repayment of principal and finance charges. The total finance charges under the lease should be allocated throughout the lease term using a constant rate of interest.

2.79 Compensated Deductions and Reduction of Reserves

1. Refer to Tax Code.

Example

During 1998 Georgian Firm TA performed repair work for Firm DB on a contract basis. TA completed the work required under the contract and charged DB 24000 GEL for the work performed. TA, an accrual basis taxpayer, included the 24000 in the income it reported in 1998, and computed and paid its tax liability based on the inclusion of this amount in income. DB did not pay TA any of the 24000 owed in 1998.

In 1999 DB notified TA the business was being liquidated and that it would be able to pay only 4000 of the 24000 debt. In 1999 DB paid TA 4000 GEL, and TA wrote off the remaining 20000 debt from its books. In 1999 pursuant to article 51 TA claimed a doubtful debt deduction for 20000 GEL, the amount of the doubtful debt it wrote off. The 4000 GEL payment TA received from DB in 1999 was not be included in 1999 income because it was previously included in income in 1998.

In year 2000 DB notified TA it was able to satisfy 1000 of the 20000 GEL debt that TA previously deducted as a doubtful debt, and paid TA this amount (1000

GEL). Per article 79, in tax year 2000 TA will include in income 1000 of the doubtful debt that it deducted in the prior year.

2. Refer to Tax Code.

2.80 Income and Losses from the Supply of Assets

1. Profit from the supply (as defined in article 29(15) of an asset (other than assets described in subarticle 3) is equal to the amount realized upon the supply of the asset, less the cost of the asset (as defined in article 81 of the Tax Code).
 - a. The profit realized from the supply of an asset on a gratuitous basis or at a reduced price is equal to the market value of the property transferred less the cost of the asset (as defined in article 81).
 - b. When all or part of the part of the purchase price of an asset is in a form other than cash, the market value of the asset or assets received is used to compute the profit (or loss) on the asset supplied.
2. Loss from the supply of an asset (other than assets described in subarticle 3) is equal to the negative difference between the amount realized upon the supply of the asset and the cost of the asset (as defined in article 81 of the Tax Code).
3. Subarticles 1 and 2 do not apply to assets subject to asset groups depreciated under article 54(3).

2.81 Cost of Assets

1. Refer to Tax Code.

“Assets” included in this article include:

- a. tangible assets (“fixed assets” defined in article 29(19)) that are depreciable under article 54;
- b. tangible assets not depreciable under article 54; and
- c. intangible assets. Intangible assets include patents, trademarks, and other forms of non-material assets. The cost of intangible assets includes acquisition expenses (such as bank fees and brokerage fees) and other expenses incurred in the creation or enhancement of the intangible asset, provided such expenses are not deducted at the time of acquisition.

Example

In 1999 Georgian Firm FF constructed a warehouse to store its inventory. The following costs were incurred in constructing the warehouse.

<i>Land</i>	<i>30000</i>
<i>Legal fees to obtain title to the land</i>	<i>3000</i>
<i>Building permits</i>	<i>2000</i>
<i>Architect plans</i>	<i>4000</i>
<i>Building materials</i>	<i>25000</i>
<i>Labor</i>	<i><u>11000</u></i>
<i>Total</i>	<i><u>75000</u></i>

All of the costs listed above will be included in determining the cost of the warehouse (75000 GEL).

2. When part of an asset is sold or transferred the total cost of the asset is allocated between the part sold or transferred and the remaining asset. The allocation is to be made using a method that reasonably reflects the allocation of costs between the asset sold and the remaining asset.

Example

Assume the same facts as provided in the example in subarticle 1, above. After constructing the warehouse Georgian Firm FF sold 1/3 of the warehouse to an outside party. For purposes of computing its profit under article 80 on the part of the warehouse it sold, Firm FF allocated the total cost of the warehouse based on physical area. As a result, FF allocated 1/3 of the total cost of the asset (25000 GEL) to the part of the warehouse it sold, and allocated the remaining 2/3 (50000 GEL) to the portion of the warehouse it retained.

2.82 Non-recognition of Profit or Loss

1. Profit or loss resulting from the following transactions is not considered in computing taxable income:
 - a. a transfer of assets between spouses;
 - b. a transfer of assets between former spouses the time of divorce; or
 - c. an involuntary destruction or condemnation of an asset where the proceeds are reinvested in an asset of the same nature before the end of the second year following the year in which the destruction or condemnation occurred.

If only part of the proceeds are reinvested the amount reinvested minus the cost basis of the asset (as determined in article 80) will not be included in income. The remaining gain (equal to the proceeds received minus proceeds reinvested) will be included in income.

Example 1

Prior to July 1998 Georgian Firm DIG conducted entrepreneurial activities from its office in Georgia. The depreciated amount of the building was 42000 GEL. In July of 1998 the state of Georgia acquired the building owned by DIG by condemnation, and the state paid DIG 49000 for the building.

The gain of 7000 GEL realized by DIG will not be included in taxable income if DIG purchases similar replacement assets in the amount of 49000 GEL (the amount received as a result of the condemnation) before the end of the second tax year following the tax year in which the condemnation took place. Therefore, DIG has until 31 December 2000 to purchase replacement assets in order not to recognize the gain or loss on the condemnation of the building.

If DIG purchases replacement assets in 1998, 1999 or 2000 at a cost of 49000 GEL or more it will not include the 7000 GEL profit from the condemnation in its profit tax return. Per article 82(2), the cost of property transferred will become the cost of the replacement property.

Example 2

Assume the same facts as in Example 1, above, but assume DIG purchased a replacement asset (building) on December 31, 2000 for 45000. In year 2000 DIG will include 4000 in income, computed as follows.

<i>Proceeds received on seizure</i>	<i>49000</i>
<i>Less: proceeds reinvested</i>	<i><u>(45000)</u></i>
<i>Profit included in income</i>	<i>4000</i>

The remaining 3000 of the 7000 total profit (49000 proceeds less 42000 cost basis) will not be included in income.

2. In cases involving the involuntary destruction or condemnation of an asset as provided in 82(1)(c), the cost of the transferred asset at the moment of destruction or condemnation will be used as the cost of the replacement asset.
 - a. Depreciation charges, if applicable, will continue to apply to the replacement property.
 - b. Because there is no change in the taxpayer's cost basis, profit or loss attributable to the asset will be deferred until the asset is transferred in a transaction that is not subject to article 82.

Example 1

In 1998 Ramaz, a Georgian resident, purchased a dacha outside Tbilisi. The cost of the dacha (per article 81) was 40000 GEL. Because the dacha was held for personal use it was not subject to depreciation under article 54. Ramaz insured the dacha against damage. In July 1998 a tree fell on the dacha and caused substantial damage. A contractor estimated the cost of repairs to the dacha to be 8000 GEL. In August 1998 the insurance company paid Ramaz 8000 GEL for the damages.

The damage caused by the tree is considered an involuntary destruction of an asset under article 82(1)(c). If Ramaz uses all of the insurance proceeds to repair the dacha Ramaz will not include the 8000 GEL insurance payment in his 1998 income per article 82(1), and Ramaz' cost basis in the dacha will remain 40000 GEL.

Example 2

Assume the same facts as above, but that Ramaz decides to sell the dacha (without repairs), and uses the insurance proceeds from the dacha to purchase a new car. Because the proceeds are not reinvested in a similar asset, article 82 will not apply and Ramaz will include the 8000 GEL insurance proceeds in income, and will recognize any gain or loss on the sale of the dacha.

3. Refer to Tax Code.
4. The nonrecognition treatment provided in 82(1) does not apply to assets subject to the group method of depreciation as provided in article 54 unless all assets in the group are transferred simultaneously.

2.83 Liquidation

1. For purposes of the Tax Code, the complete liquidation of a legal person is considered to be a sale by the partners of their share in the liquidated legal person. “Liquidation” is defined as a termination and dissolution of a legal person whereby its liabilities are paid off and any remaining assets are distributed.

Example

Georgian Firm VV, a legal person, was owned 60 percent by Dima and 40 percent by Nato, both physical persons. Dima paid 600 GEL for his share of VV, while Nato paid 400 GEL for her share in VV. In 1998 VV was completely liquidated. As part of the liquidation proceeds Dima received 60 GEL and Nato received 40 GEL.

Under article 83(1) of the Tax Code the complete liquidation of VV is considered a sale by Dima and Nato of their shares of VV. As a result, Dima and Nato will report the following loss from the liquidation.

	<u>Dima</u>	<u>Nato</u>
<i>Income received from liquidation of VV</i>	60	40
<i>Less: cost of shares in VV</i>	(600)	(400)
<i>Loss from liquidation</i>	(540)	(360)

2. Subject to the restriction provided in subarticle 5 below, if a legal person is liquidated and its assets are transferred to one or more partners that are also legal persons, the value of the assets transferred to each partner is deemed to be equal to the partner’s share in the liquidated legal person.

If the partner receiving the liquidated assets held an interest of 50 percent or more in the liquidated legal person immediately prior to the liquidation:

- a. The transfer of liquidated assets is not treated as a sale of the asset by the liquidated legal person;
- b. The cost to the partner of the assets received from the liquidated legal person is deemed to be equal to the cost basis of such assets to the liquidated legal person prior to the transfer;
- c. The distribution of assets is not considered a dividend to the asset recipients; and
- d. Profit and loss is not recognized on the cancellation of the partner's share in the liquidated legal person.

Example

Georgian Firm TT, a legal person, was owned 60 percent by Georgian Firm DI and 40 percent by Georgian Firm PP, both of which are legal persons. DI paid 6000 GEL for its shares of TT, while PP paid 4000 GEL for its shares. In 1998 TT was completely liquidated. As part of the liquidation proceeds DI received assets with a cost basis to TT of 600 GEL, while PP received assets with a cost basis to TT of 400 GEL. The assets received were not assets that were subject to depreciation using the group method as provided in article 54. (See article 83(3) below.)

Article 83(1) of the Tax Code provides that the complete liquidation of TT is considered a sale by the partners of their shares in the liquidated legal person. However, under article 83(2) profit or loss from liquidation is not recognized by a legal person shareholder that owns 50 percent or more of the liquidated legal person. Accordingly, Firm PP, which owned 40 percent of the liquidated TT, will report the liquidation as a sale under article 83(1). DI, which owned more than 50 percent of the liquidated TT, will report the liquidation in accordance with the provisions contained in article 83(2). The results will be as follows.

Firm PP

<i>Assets received from liquidation of TT (market value)</i>	<i>400</i>
<i>Less: cost of shares in TT</i>	<i><u>(4000)</u></i>
<i>Loss from liquidation</i>	<i>(3600)</i>

Under 83(1) Firm PP will report the loss of 3600 GEL from the liquidation of TT on its 1998 profit return.

Firm DI

<i>Assets received from liquidation of TT (market value)</i>	<i>600</i>
<i>Less: cost of shares in TT</i>	<i><u>(6000)</u></i>
<i>Loss from liquidation</i>	<i>(5400)</i>

Under article 83(2) DI will assume the same cost basis as TT had in the liquidated assets (600 GEL). Under article 83(2)(d) DI will not include the loss of 5400 GEL from the liquidation of TT in its 1998 profit return.

3. This article does not apply to any assets that are subject to depreciation using the group method as provided in article 54 unless all assets in the group are transferred simultaneously.
4. In the case of an asset referred to in part 3 of this article the asset recipient takes as the cost of the asset the balance of the group at the time of transfer. When more than one such asset is transferred the balance of the group is divided among the assets in proportion to their market values at the time of transfer.
5. The provisions in subarticle 2 above apply only if the complete liquidation is approved by the tax agency as not having tax avoidance as a principal objective. Per article 257, the burden of proof is on the taxpayer to establish that tax avoidance was not the principal objective of the complete liquidation.

2.84 Procedure for Determining the Cost of Assets Transferred in Exchange for a Partner's Share

1. The transfer of assets is not treated as a sale of assets and gain or loss is not recognized if:
 - a. a legal or physical person or group of persons (transferor) transfers one or more assets (with or without any liability) but subject to subarticle 6 below, to a legal person (transferee) in exchange for one or more shares in the legal person; and
 - b. immediately after the transfer the transferor(s) own directly 50 percent or more of the shares of the legal person. Any shares held by the transferor prior to the transfer of assets are also included in determining whether the transferor meets the 50 percent ownership test.
2. The transferor's cost basis in the transferred assets at the moment of transfer will become the transferee's cost basis.
3. The transferor's cost basis in the shares received will be equal to the cost basis of the transferred assets less any liability transferred (subject to 6, below).

Example 1

Giorgi, Zura and Inga, all physical persons, own equally an office building in Tbilisi. Their total cost basis in the building is 90000 GEL. In 1999 they transferred the building to Georgian Firm RR, a legal person, for a 70 percent share in RR. At the time of the transfer their 70 percent share in RR had a market value of 120000 GEL.

Because Giorgi, Zura and Inga transferred the building as a group and possess 50 percent or more of the shares of RR immediately after the transfer of the building they will treat the transfer as a sale and will not recognize a profit on the transfer under article 80.

Per article 84(2), RR will assume the transferee's cost basis in the building of 90000 GEL. Per article 84(3), Giorgi, Zura and Inga will each have a 30000 GEL (90000 total basis / 3 transferors) in the shares they received from RR.

Example 2

Giorgi, Zura and Inga, all physical persons, own equally an office building in Tbilisi. Their total cost basis in the building is 90000 GEL. In 1999 they transferred the building to Georgian Firm RR, a legal person, for a 30 percent share in RR. Prior to this transfer Giorgi, Zura and Inga owned a 25 percent share of RR.

Because Giorgi, Zura and Inga transferred the building as a group and possess 50 percent or more of the shares of RR immediately after the transfer of the building they will treat the transfer as a sale and will not recognize a profit or loss on the transfer under article 80.

Example 3

Nellie, a Georgian resident, and Georgian Firm FI, a legal person, decide to form Firm YY, a legal person. Nellie will transfer to YY a building that she has been renting to tenants. Nellie's depreciated basis in the building is 10000 GEL, and the building has a value of 40000 GEL on the date of the transfer. FI transfers 40000 GEL to YY. For their transferred assets, Nellie and FI each receive 50 percent of the shares of YY.

Because article 82 applies to this transaction, Nellie will not recognize a 30000 GEL (40000 less 10000 basis) gain under article 80, but rather will defer recognition of the gain she realized on the transfer. Per article 84(3), Nellie will assume a basis in the YY shares she received of 10000 GEL (her basis in the building at the time of transfer), while Firm FI will have a 40000 GEL (the amount of the money transferred) basis in the shares it received. Per article 84(2), YY will assume Nellie's depreciated basis in the building (10000 GEL).

Article 84(4) below, does not apply to this transaction because buildings are depreciated separately, and are not depreciated using the pooling method under article 54.

4. This article does not apply to any assets that are subject to depreciation using the group method as provided in article 54 unless all assets in the group are transferred simultaneously.
5. Refer to Tax Code for rules that apply if all subject to depreciation using the group method are transferred simultaneously per article 84(4). If more than one asset described in article 84(4) is transferred the value balance of the group is distributed among the assets pro rata to their market price at the moment of a transfer.

Example

In January 1999 Georgian Firm UH purchased 5 trucks for a total of 100000 GEL. In 1999 the trucks were the only assets in UH's Group 2 asset category, and were subject to depreciation under article 54. In October 1999 UH transferred the 5 trucks to Georgian Firm BB for 60 percent of the shares of BB. At the time of transfer the 60 percent share in BB had a market value of 105000 GEL. The market value of the trucks was 105000, and all the trucks were of equal value.

Article 84 generally does not apply to transferred assets that are depreciated using the group method under article 54. However, if all assets in the group are transferred simultaneously, as in this example, article 84 will apply to the transfer. Per article 84(5)(a) BB, the transferee, will assume UH's cost basis in the trucks. The 100000 GEL balance for the assets (trucks) in Group 2 will be apportioned to the assets (5 trucks) according to their market value. Therefore, each truck will have a cost basis to BB of 20000 GEL (100000 GEL / 5 trucks). Per article 84(5)(b) UH, the transferor, will have a cost basis in the shares acquired from BB equal to the balance of the assets it transferred, or 100000 GEL.

6. Article 84 does not apply to the transaction if the indebtedness transferred by the transferor exceeds the cost basis of the assets transferred by that transferor.

Example

Nellie, a Georgian resident, and Georgian Firm FI, a legal person, decide to form Firm YY, a legal person. Nellie will transfer to YY a building that she has been renting to tenants. Nellie's depreciated basis in the building is 10000 GEL, and the building has a value of 40000 GEL on the date of the transfer. The building is subject to indebtedness of 120000 GEL, which Nellie transfers to YY along with the building. FI transfers 280000 GEL to YY. For their transferred assets, Nellie and FI each receive 50 percent of the shares of YY.

Because the indebtedness (120000 GEL) transferred by Nellie exceeds her cost basis in the assets transferred (10000 GEL), article 82 will not apply to Nellie, and she will have to recognize a gain on the transfer.

2.85 Reorganization of Legal Persons

1. The cost basis of property and shares owned by legal persons that are parties to an approved reorganization transaction (as described in subarticle 7, below) is the same as the cost of such property and shares before the reorganization.
2. Refer to Tax Code.
3. Refer to Tax Code.
4. Refer to Tax Code.
5. Refer to Tax Code.

Example

Georgian Firm BN is wholly owned by Georgian Firm CC, and CC has a 40000 GEL cost basis in its shares of BN. Georgian Firm VM is wholly owned by Georgian Firm DD, and DD has a 50000 GEL cost basis in its shares of BN. CC and DD are legal persons. Under an approved reorganization transition as provided in article 85(7), BN and VM were merged into new firm YY. CC and DD exchanged their shares in the merged firms for new shares of YY.

Per article 85(1-4) CC and DD will not recognize a gain or loss on the shares they exchanged for shares in YY pursuant to the reorganization. CC and DD will transfer their cost basis in the shares they exchanged (40000 and 50000 GEL, respectively) to the new shares of YY they received pursuant to the reorganization.

6. Refer to Tax Code.
7. Refer to Tax Code.
8. Refer to Tax Code.
9. Refer to Tax Code.
10. Refer to Tax Code.
11. Refer to Tax Code.

2.86 Limitation of the Carrying Forward of a Loss and Deduction in Case of Change of Ownership of Shares of a Legal Person

If there is a change in a legal person from the previous year of 50 percent or more shares that have voting rights, beginning in the tax year in which the ownership change occurred the legal person may not carryforward losses, deductions or credits pursuant to article 61 unless:

- a. for a period of three years after the change the legal person continues to conduct the same entrepreneurial activities as it conducted prior to the ownership change, or
- b. the legal person begins a new entrepreneurial activity with the consent of the tax agency.

Example 1

At the beginning of 1998 Georgian Firm SS, a legal person, is owned as follows.

<u>Shareholder</u>	<u>Shares owned</u>
Dato	20
Afto	60
Maia	10
Natia	<u>10</u>
Total	100 shares

All of the shares contain voting rights.

In 1998 SS incurred a loss of 20000 GEL which was eligible for carryforward under article 61.

In 1999 the ownership of SS changed as follows.

<u>Shareholder</u>	<u>Shares owned</u>
Dato	20
Afto	0
Maia	10
Natia	10
Tika	30
Katy	<u>30</u>
Total	100 shares

In 1999 there was a change in ownership of 50 percent or more of the shares of SS with voting rights. Therefore, beginning in the year the ownership changed occurred (1999), SS will not be able to carryforward the 20000 GEL loss it incurred in 1998 unless:

1. *for a period of three years after the change in ownership (tax years 2000, 2001 and 2002) SS continues to conduct the same entrepreneurial activities as it conducted prior to the ownership change, and*

2. *SS begins a new entrepreneurial activity with the consent of the tax agency.*

If SS continues to conduct the same entrepreneurial activities as it conducted prior to the ownership change and begins a new entrepreneurial activity with the consent of the tax agency it may utilize the carryforward the 1998 loss to 1999 or later years (pursuant to article 61 of the Tax Code). However, if SS fails to conduct the same entrepreneurial activities as it conducted prior to the ownership change until January 1, 2003, it must file amended returns for any prior years in which it utilized any part of the 20000 GEL loss it incurred in 1998.

Example 2

At the beginning of 1998 Georgian Firm RR, a legal person, is owned as follows.

<u>Shareholder</u>	<u>Shares owned</u>
Dato	20
Afto	40
Maia	30
Natia	<u>10</u>
Total	100 shares

All of the shares contain voting rights.

In 1998 RR incurred a loss of 30000 GEL which was eligible for carryforward under article 61.

In 1999 the ownership of RR changed as follows.

<u>Shareholder</u>	<u>Shares owned</u>
Dato	20
Afto	40
Maia	0
Natia	0
Tika	<u>40</u>
Total	100 shares

In 1999 there was not a change in 50 percent or more of the shares of RR with voting rights. Therefore, RR will be able to carryforward the 30000 GEL loss it incurred in 1998 (pursuant to article 61).

Chapter 10. Tax Administration Provisions

2.87 Filing of Returns

1. Refer to Tax Code. (See also article 232 for rules regarding extensions of time to file a return.)
2. Refer to Tax Code.
3. Upon the decision to liquidate (as defined in instruction article 2.83(1)) a legal person:
 - a. The legal person or the liquidation committee of the legal person must provide written notification of the intent to the tax agency where the legal person is registered for tax purposes. The notification must be provided no later than 7 days following the date the decision to liquidate is made.
 - b. Within 15 business days following the date the decision to liquidate is made the legal person or the liquidation committee shall file a profit tax declaration with the tax agency where the legal person is registered for tax purposes.

Example

On July 1, 1999 the liquidation committee established by Georgian Firm EW, a legal person, decide to liquidate EW. Prior to July 8, 1999 EW or the liquidation committee must notify the tax agency where EW is registered of the intent to liquidate. Prior to July 16, 1999 the liquidation committee must file a profit tax declaration at the tax agency where the legal person is registered for tax purposes.

4. Refer to Tax Code.
5. Refer to Tax Code. See article 64(5) and the example provided therein.

2.88 Procedure for Withholding Tax at the Source of Payment

1. Refer to Tax Code.

In accordance with the Vienna Convention of 1961 diplomatic missions are not subject to the withholding requirement.

2. Refer to Tax Code.

3. Refer to Tax Code.

4. A person who is not the principal employer of a taxpayer is required to withhold tax at the top marginal rate according to article 42. Such an employer does not subtract the monthly deduction provided in article 41.

Example

Georgian Firm LL is the principal employer of Tika, a Georgian resident. Tika also is employed at Georgian Firm EJ. In January 1999 Tika's gross wages from EJ were 50 GEL.

Because EJ is not Tika's principal employer, it must withhold tax on Tika's earnings at the top marginal rate (20 percent) provided under article 42, without regard to the monthly deduction provided in article 41. As a result, EJ will withhold 10 GEL in taxes on Tika's gross wages of 50 GEL.

5. Refer to Tax Code.

Example

Firm NGO, a legal person, was established to implement an environmental project in Georgia pursuant to an international agreement between Sweden and Georgia. The agreement was signed and ratified by Georgia in 1998. NGO pays wages to its three Georgian resident employees.

Pursuant to article 88(5), NGO must provide the appropriate tax agency information (as described in article 88(3)(c)) concerning its employees and amount of wages it paid to its employees within 30 days after the end of the tax year. If NGO provides such information it is not required to act as a tax agent and withhold taxes from wages it pays to its employees. However, if NGO falls to provide such information it will then be considered to be a tax agent and must withhold taxes on wages paid to its employees pursuant to article 88(1).

2.89 Current Tax Payment

1. Subject to subarticle 3 below, physical and legal persons engaged in entrepreneurial activity are required to make current tax payments for income and profit taxes in the current tax year based on the tax reported in the preceding tax year according to the following payment schedule.

<u>Quarter</u>	<u>Current tax rate</u>	<u>Payment due date</u>
January-March	30 percent	May 15
April-June	30 percent	August 15
July-September	40 percent	November 15

Example

For the 1998 tax year Georgian Firm GORDA, a legal person, had a profit tax liability of 5000 GEL. In 1999, GORDA is required to make current profit tax payments as follows (unless it qualifies within 3, below).

<u>Quarter</u>	<u>Current tax payment</u>	<u>Payment due date</u>
January-March	1500 GEL (5000 GEL * 30 percent)	May 15
April-June	1500 GEL (5000 GEL * 30 percent)	August 15
July-September	2000 GEL (5000 GEL * 40 percent)	November 15

2. Subject to subarticle 3 below, physical and legal persons engaged in entrepreneurial activity who did not incur a tax liability in the preceding tax year are to pay taxes in the current year based on the amount of income or profit, less deductions, reported in the previous quarter of the current tax year.
 - a. For purposes of article 89(2) the actual income from the previous quarter of the current year may be reduced by 25 percent of depreciation deduction reported during the previous tax year.
 - b. The tax rate will be applied to the actual income reported during the quarter rather than to the income reported according to the rules provided in article 89(1) above.
 - c. Taxpayers subject to this subarticle must submit their tax payment by the dates prescribed in article 89(1).
 - d. Taxpayers subject to this subarticle must submit a quarterly tax return by the 20th day of the second month of the next quarter, as follows.

<u>Quarter</u>	<u>Due date of return</u>
January-March	May 20
April-June	August 20
July-September	November 20

- e. Taxpayers are subject to fines and penalties and prescribed by article 253 for in the event returns are not submitted by the due dates prescribed in article 89(2)(c).

Example

Georgian Firm NEW began operations on May 10, 1999. The second quarter (April-June) of 1999 was the first quarter NEW reported income. In the second quarter NEW reported 15000 GEL in income and 5000 GEL in deductions, resulting in 10000 taxable profit.

*NEW did not have any income in the first quarter and therefore is not required to make a tax payment for this quarter. NEW is required to make a tax payment for the second quarter based on the actual income it earned in that quarter, less deductions. NEW will make a tax payment of 2000 GEL $([15000 - 10000] * 20 \%)$ by August 15, 1999. In addition, NEW must submit a quarterly tax return prior to August 20, 1999.*

3. If a taxpayer projects that his/her income or profit in the current tax year will be at least 30 percent less than the income or profit reported in the previous year, the taxpayer may petition the tax agency to reduce the amount of current tax to be paid in the current year.
 - a. The petition to the tax agency requesting a reduction in the current tax amount must be made to the tax agency at least one month prior to the current tax payment due date.
 - b. If the tax agency grant's the taxpayer's petition the taxpayer's current tax will be reduced proportionally based on the taxpayer's projected income or profit.
 - c. If taxpayer's current tax is reduced and it is subsequently determined that the taxpayer's actual income or profit is greater than the amount projected by the taxpayer, the taxpayer will be required to make additional current tax payments equal to the difference between the current tax paid for the quarter and the amount of tax due on the actual income or profit, less deductions, earned during the quarter. Tax returns are to be submitted pursuant to the rules provided in article 230.
 - d. The taxpayer is subject to fines and penalties and prescribed by article 252 for current taxes and additional current taxes imposed by article 89(3)(d) on amounts not paid by the prescribed due date.

Example

*In 1998 Georgian Firm MIMI, a legal person, reported income 25000 GEL, deductions of 8750, and taxable profit of 16250 GEL. In 1998 MIMI paid 3250 GEL $(16250 * 20 \text{ percent})$ in profit tax.*

MIMI's 3250 GEL profit tax liability reported in 1998 is used to determine MIMI's 1999 current tax payments. As a result, MIMI's 1999 current taxes, with payments dates, will be as follows.

<i>Quarter</i>	<i>Amount</i>	<i>Payment due date (1999)</i>
<i>First</i>	<i>975 GEL (3250 x 30%)</i>	<i>May 15</i>
<i>Second</i>	<i>975 GEL (3250 x 30%)</i>	<i>August 15</i>
<i>Third</i>	<i>1300 GEL (3250 x 40%)</i>	<i>November 15</i>
<i>Total 1999</i>	<i>3250 GEL</i>	

Prior to April 15, 1999 MIMI submitted a petition (with supporting documentation) to the tax agency to reduce its 1999 current tax payments because it expected its 1999 to be 14500 GEL, which is 42 percent less than the 25000 GEL income it reported in 1998.

Based on the documentation submitted by MIMI the tax agency reduced MIMI's 1999 current tax payments by 42 percent, resulting in the following payments.

<i>Quarter</i>	<i>Amount</i>	<i>Payment due date (1999)</i>
<i>First</i>	<i>566 (975 – [975 * 42 30%])</i>	<i>May 15</i>
<i>Second</i>	<i>566 (975 – [975 * 42 30%])</i>	<i>August 15</i>
<i>Third</i>	<i>754 (1300 – [1300 * 42%])</i>	<i>November 15</i>
<i>Total</i>	<i>1885 (3250 – [3250 * 42%])</i>	

MIMI will be subject to fines and penalties if it does not pay the current tax amounts by the prescribed due dates. MIMI will also be subject to fines and penalties if it earns more than the projected amounts and does not pay the increase in current tax by the prescribed due date.

4. Current payments made by a taxpayer during a tax year are applied to reduce the taxpayer's total tax liability determined at the end of the tax year.

Current tax payments are to be paid pursuant to the rules provided in article 239. Failure to comply with the provisions in article 89 may subject the taxpayer to fines and penalties imposed by articles 223, 251, 252, 253 and 254 of the Tax Code.

END OF INCOME AND PROFIT TAX INSTRUCTIONS

Part III. Value Added Tax

Chapter 11. General Provisions

3.90 Concept of Value Added Tax

The underlying principle of Value Added Tax (VAT) is that the tax is levied at each stage of supply of goods, works and services (defined in article 29) and upon the value added at each stage; e.g. tax is paid by manufacturers on the cost of making an item, by wholesalers on the price that they charge to retailers and by retailers on the price that they charge to the consumer. Each party in the process must account to the tax authority for the tax on their output but may deduct from this figure the tax already charged by the party that supplied them. Looking at this in reverse, an article charged at 24 GEL (inclusive of VAT), assuming a rate of VAT of 20 percent, the tax is 4 GEL, i.e. one sixth of the total price. Although the tax authorities are entitled to 4 GEL they will receive it in stages determined by the number of registered taxpayers through which the article passes on its way to the consumer. Part will be paid by the manufacturer, part by the wholesaler and part by the retailer. Each of these portions will be paid at different times.

Therefore, VAT is a general tax on consumption applied at each point of exchange of goods, works and services from primary production to final consumption. It is levied on the difference between the sale price of the goods, works and services (outputs) and the cost of bought-in inputs. At each point in the exchange the tax is passed on in the form of higher prices. Consequently economic enterprises registered for VAT do not bear any VAT that is included in the invoices for the inputs that they buy from suppliers; they are able to reclaim this as an input tax credit. Being at the final point in the chain of exchange, the final consumer bears the whole tax in the same way as if it were a sales tax levied at the retail level. This is achieved by allowing the registered VAT enterprise to claim a credit for the VAT that it has paid on all of the goods, works and services that have been supplied to it for the purposes of its economic activity.

3.91 Taxpayers

1. Refer to the Tax Code. For VAT purposes partnerships are considered persons.
2. Refer to Tax Code.
3. Refer to Tax Code.
4. A non-resident person not registered for VAT who carries out works or performs services on the territory of Georgia that are subject to taxation is considered to be a taxpayer in respect to such works or services and is subject to reverse charge under article 108 and instruction article 3.108.
5. Branches, divisions, and other structural subdivisions that have a separate balance sheet and a separate settlement or other account as described in article 12(1)(c) are regarded as independent persons and shall be registered as VAT payers if the gross taxable turnover of the enterprise in total exceeds the threshold necessary for mandatory registration under article 92.

Example

Enterprise ZZ has three branches. The turnover of the enterprise and the branches within the previous 12-month period in the accounting period is as follows.

<i>Enterprise (without branches)</i>	<i>20000 GEL</i>
<i>Branch 1</i>	<i>4000 GEL</i>
<i>Branch 2</i>	<i>5000 GEL</i>
<i>Branch 3</i>	<i><u>8000 GEL</u></i>
<i>Total turnover</i>	<i>37000 GEL</i>

As the gross taxable turnover of ZZ and its branches exceeds the amount stipulated in article 92(1) (24000 GEL), ZZ and each of its branches are required to be registered as VAT taxpayers.

3.92 Mandatory Registration

1. Refer to Tax Code. For the purpose of VAT payers' registration, the continuous 12-month period prior to the first date of each month shall be regarded as a 12-month period.

Example

A person started an economic activity in April 1999. His monthly taxable turnover was as follows.

<i>Month</i>	<i>Monthly Turnover</i>	<i>Aggregate Turnover</i>
<i>1999 Year</i>		
<i>April</i>	<i>400</i>	<i>400</i>
<i>May</i>	<i>800</i>	<i>1200</i>
<i>June</i>	<i>2000</i>	<i>3200</i>
<i>July</i>	<i>5000</i>	<i>8200</i>
<i>August</i>	<i>700</i>	<i>8900</i>
<i>September</i>	<i>400</i>	<i>9300</i>
<i>October</i>	<i>300</i>	<i>9600</i>
<i>November</i>	<i>900</i>	<i>10500</i>
<i>December</i>	<i>1000</i>	<i>11500</i>
<i>2000 Year</i>		
<i>January</i>	<i>0</i>	<i>11500</i>
<i>February</i>	<i>1000</i>	<i>12500</i>
<i>March</i>	<i>2000</i>	<i>14500</i>
<i>April</i>	<i>3000</i>	<i>17100</i>
<i>May</i>	<i>2000</i>	<i>18300</i>
<i>June</i>	<i>4000</i>	<i>20300</i>
<i>July</i>	<i>6000</i>	<i>21300</i>
<i>August 4</i>	<i>5000</i>	<i>25600</i>

The registration threshold of 24000 GEL of taxable transactions was exceeded on August 4, 2000. On August 5, 2000 the person should submit an application to the tax agency to be registered as a VAT taxpayer. This person is regarded as a VAT payer from August 5, 2000.

If the total amount of taxable transactions exceeded 24000 GEL in a less than a 12-month period, the person is required to be register on the day after the 24000 threshold is exceeded.

An enterprise applying for mandatory registration of branches is required to file an application with the local tax agency, which will issue to the enterprise a certificate of registration. The tax agency effecting the registration of the enterprise will notify the tax agencies where the branches are located. These tax agencies will then register the branches as independent taxpayers.

2. Refer to Tax Code.
3. For purposes of VAT mandatory registration of a non-resident, only the supply of goods, fulfillment of works, and rendering of services carried out in Georgia through a permanent establishment in Georgia by a non-resident are taken into account while determining the total value of taxable transactions

A non-resident may be registered only if he/she carries out an economic activity through a permanent establishment in Georgia. Article 17(1) of the Tax Code defines a permanent establishment of a foreign physical person or enterprise as the establishment through which it carries out, in full or in part, an economic activity defined in article 7. Article 17(3)(d) does not consider a place to be a permanent establishment of a foreign enterprise in Georgia if it is used only to perform any other activities that are preparatory or auxiliary in nature coming from the interests of the foreign enterprise. As a result a non-resident may be registered only if has a permanent establishment through which he carries out an economic activity in whole or in part.

Example 1

A foreign enterprise establishes an operation in Tbilisi to advertise and promote its products. These products are imported by other enterprises and the foreign enterprise itself makes no sales. The enterprise imports advertising and promotional material. It also contracts in Georgia to produce advertisements on television and elsewhere. It receives no income from its own activities in Georgia. As such it does not carry out an economic activity and is not required to register for Value Added Tax in Georgia. It must pay VAT on its imports of goods and services (reverse charge) and also upon the supplies made to it in Georgia by Georgian enterprises that are registered for VAT. It has no entitlement to input tax credit.

Example 2

An advertising agency of a foreign enterprise does not have a permanent establishment in Georgia if the activities that it performs are 'preparatory or auxiliary in nature' to the interests of the foreign enterprise. Therefore as a foreign enterprise with no permanent establishment in Georgia it cannot be registered for VAT under Article 92. As it is unable to be registered for VAT it cannot reclaim any of the VAT that it pays on the goods, works or services that it buys in Georgia or imports from another state.

If the advertising agency does some advertising for Georgian enterprises and/or other enterprises that have a permanent establishment in Georgia it does have a permanent establishment in Georgia provided that it is paid for this service. Having a permanent establishment enables it to be registered for VAT provided its turnover exceeds 24000 GEL and is of a chargeable nature. However, the advertising that it does for its own products is for the production and sale of the goods that are manufactured in the foreign state. Under article 107 the place where the advertising service is rendered is in the foreign state and not Georgia. (See article 107(1)(e) and (f).) But the zero rating of exports is

limited to goods and does not cover works and/or services. Therefore, although the supply of the service is an export there is no entitlement to zero rating. However as the place of supply of its own advertising is considered to be in the foreign state and not in Georgia, it is not chargeable with VAT in Georgia. As there is no provision for the zero rating of services that are 'exported' the supply of its own advertising is outside the scope of VAT and, therefore, is not a taxable transaction. The value of these supplies cannot be included in its taxable turnover and the provisions of article 114(2) will apply. If the remaining turnover is sufficient to meet the requirements of registration any input tax credit has to be proportioned.

3.93 Voluntary Registration

Refer to Tax Code.

3.94 Registration

1. Refer to Tax Code.
2. Refer to Tax Code.
3. Refer to Tax Code.

In the example provided in instruction article 3.92(1) the effective date of mandatory registration is August 5, 2000, or the date when the application is submitted to the Tax Agency. Similarly, for a voluntary registration under article 93 the effective date of registration is the date the person applied for registration.

4. In the case of a person requiring to register for VAT and not making application to be registered, the registration is effective on the date when the duty to apply for registration arose. The person is entitled to invoicing only from the date of registration as a VAT payer when tax invoices are issued to him/her.

Example

The amount of taxable transaction carried out by an economic enterprise through up to September 26, 2000 (inclusive) exceeded 24000 GEL. In this case the enterprise is required to file application for mandatory registration as a VAT payer to the tax agency before September 27, but it continues to carry out its economic activity without making an application. On December 15, 2000, the Tax Inspection establishes that the enterprise carries out an economic activity without making application for registration for VAT. With effect from December 15, 2000, the tax authority registers the person on its own initiative, and issues to him the tax certificate and invoices. In this case the person is considered to be a VAT payer from the date when the duty to apply for registration arose (September 27, 2000), and must account for VAT on all of his outputs together with applicable financial sanctions. However his right to use tax invoices will be

from December 15, 2000, i.e. from the date when the Tax Inspection issued to the person the certificate and the invoices. A person who carries out taxable transactions at zero rate is subject to VAT registration to get the right of VAT credit (reimburse).

5. Refer to Tax Code.

3.95 Termination of Registration

1. Refer to Tax Code.

2. Refer to Tax Code.

Example 1

A person has started economic activity in September 2000, and was registered for VAT on October 12 of the same year. He may apply for cancellation of his registration as a VAT payer only from October 12, 2002, provided that the taxable transactions did not exceed the established threshold of 24000 GEL within the period from October 2001 to October 2002.

Example 2

Based on the facts in example 1 above, if the VAT threshold is increased prior to October 2002 and this results in taxable transactions falling below the new threshold the VAT registration maybe cancelled immediately.

3. The effective date for the cancellation of a registration is the date on which taxable transactions ceased or, if 2 above applies, from the time when the person applied to the tax agency to have his registration revoked. The taxpayer must then account for VAT on all stocks of goods on hand.
4. Upon the cancellation of a registration the tax authority should require the taxpayer to return his certificate of registration for cancellation and any unused tax invoices. Even though VAT registration of a taxpayer can be cancelled the TIN is not cancelled; it is effective during the existence of the taxpayer.

Chapter 12. Objects of Taxation

3.96 Objects of Taxation

1. Value added tax applies to all supplies goods, fulfillment of works and rendering of services (other than those specifically exempted or zero-rated) supplied or imported by an economic enterprise whose taxable turnover exceeds 24000 GEL, irrespective of whether the enterprise is registered for the tax or not. If no application for registration has been made the enterprise is liable to penalties and additionally it is required to account for tax from the date that it should have been registered.

Where excise stamps have been issued under article 134 and such stamps are not used within six months of the time of issue the rules in subarticle in 3 below will apply to the relevant imported goods.

2. Refer to Tax Code.
 - a. The following are considered not to be taxable transactions.
 - The supply of a good by a person who acquired such good in a transaction subject to VAT, but was not entitled to a credit for the VAT in accordance with article 114; if a credit was partially disallowed on the acquisition of the good, then the taxable amount is reduced proportionally to the portion of the credit that was disallowed per article 94 (7); and
 - The sale or transfer of an enterprise by a taxpayer to another taxpayer and if the supplying party and the recipient notify in writing the tax agency within 10 days of the transfer. The recipient accepts the rights and obligations which were transferred or sold.
 - b. According to article 134(4), a supply of goods to the proportional to the quantity of the excise stamps will be deemed to have occurred if excise stamps are not used due to loss, destruction, or any other reason except force majeure.

VAT will be calculated pro rata import to the non-returned excise stamps and should be accounted for on the return for the next period.

3. Where goods for which excise stamps have been issued (see article 134(4)) are not imported within six months of the issue of the stamps and the stamps have not been returned to the Excise Stamp Service for cancellation a supply of goods to the relevant quantity of the excise stamps will be deemed to have taken place. VAT will be calculated pro rata import to the non-returned excise stamps and should be accounted for on the return for the next period.
4. Refer to the Tax Code.
5. Refer to the Tax Code.
6. Refer to the Tax Code. Goods, works, and services that have not yet been supplied by a taxpayer shall be included into the stocks on hand.

7. A supply of goods by a person who acquired such good in a VAT taxable transaction, but who was not entitled to a VAT credit on the acquisition of the good according to article 114 shall not be treated as a taxable transaction. This applies to supplies that are wholly exempt from VAT under article 101. Such supplies are non-taxable supplies.

If a VAT credit has been partially disallowed, then the amount of a taxable transaction is reduced pro rata to the disallowed amount. This applies to mixed supplies when some part of the supply is exempt under article 101 and the rest of the supply is taxable. This affects the calculation of the total of a person's taxable transactions. If no input tax is allowable the supplies are excluded from the total of the taxable transactions. If input tax is allowed on a proportionate basis only that part for which a credit is allowed is included in the total of the taxable transactions.

8. Refer to the Tax Code. Returnable containers are containers that can be used more than once. This subarticle does not apply to the delivery of containers by an enterprise that manufactures containers.
9. Refer to the Tax Code. The supply of goods, rendering of services or fulfillment of works that occurs within one legal person, such as the supply between branches or other structural units as well as supply between the legal person and its branches, is deemed to be a taxable transaction.

3.97 Supply of an Enterprise

1. If two conditions (below) are satisfied a supply of an enterprise or part of a taxpayer to another taxpayer is not deemed to be a taxable transaction. Therefore, VAT must not be charged on any of the taxable elements of the supply by the vendor. Consequently there is no input tax to be claimed by the recipient.

The two conditions are:

1. the transferee of the supply must assume the same obligations as the transferor had at the moment of the supply; and
 2. within 10 days from the date of supply the tax agency must be notified in writing of such supply
2. Refer to Tax Code.
3. Refer to Tax Code.

Chapter 13. Determination of Taxable Turnover and Taxable Import

3.98 Amount of Taxable Transaction

1. Refer to Tax Code.
2. Refer to Tax Code.
3. Refer to Tax Code. If a taxpayer does not receive or is not entitled to receive goods, works, services or compensation in lieu of a taxable transaction (including goods on hand at the termination of registration or the non-return of excise stamps according to article 134), the amount of the taxable transaction is defined by the VAT exclusive market price of the goods, works or services supplied, fulfilled or rendered (including any taxes, duties or other fees payable).

Example 1

At the moment of registration termination the value of goods that a taxpayer had on hand was 100000 GEL on which the taxpayer did not get credit or pay VAT. According to article 96 the goods on hand at the effective date of cancellation of the VAT registration is deemed as a taxable supply carried out at that time and the taxpayer does not receive goods, works, services or compensation. In this case, at the moment of registration cancellation the amount of taxable transactions is 100000 GEL.

Example 2

In February 2000 an enterprise purchased 1000 excise stamps for imported 0.5 liter bottles of vodka. The Vodka marked with the excise stamps was imported in October 2000. The market price of 1000 bottles of vodka and relevant VAT should be recorded in the VAT declaration of August 2000. Sandro-why august?

4. Refer to Tax Code.

3.99 Adjustment of the Amount of Taxable Turnover

1. Refer to Tax Code.
2. Where one or more events described in article 99(1) have occurred the taxable transaction may be adjusted provided the amount of VAT shown upon the original tax invoice was different from that now proved to be correct and that the incorrect amount was accounted for in the tax return for the period concerned.
3. Before any adjustment can be made under this article, and any amount credited, the registered enterprise must have issued an amending tax invoice to the original purchaser of the goods, works or services.
4. Refer to Tax Code.

5. Refer to Tax Code.

3.100 Amount of Taxable Import

1. Refer to Tax Code. The value of services that are auxiliary to the import of goods (such as transportation) is considered a part of the import and is added to the value of the import excluding VAT.
2. Refer to Tax Code.

Chapter 14. Tax Concessions

3.101 Exemption from Tax

1. Refer to the Tax Code for a list of goods, works and services, as well as types of imports, that are exempt from VAT. Instructions on specific items are provided below.
 - a. Financial services conducted without special bank licenses required by Georgian legislation are considered as exceptions to this exemption and therefore are not exempt from VAT.
 - g. A “rent payment” is a payment received on the basis of a Rental Agreement, which is an agreement that applies to property rented for residential purposes and not for purposes of conducting economic activities.
 - p. Only those educational services that are rendered by educational institutions and meet all the license requirements issued by the Ministry of Education shall be considered as educational services.
 - q. The printing and supply of tickets includes tickets used for entertainment events.
 - w. Exemption of goods, works and services listed in this apply only if such they are registered at the Ministry of Finance.
 - z. Usage of goods listed in this item for purposes other than plant protection shall result in cancellation of exemption and tax according to the general VAT rules.
2. Refer to Tax Code.
3. Refer to Tax Code.

Note: A transaction taxed at a zero rate is not an exemption from the tax, but is a transaction with a tax rate equal to ‘zero’, i.e. 0 percent. In these circumstances the taxpayer is entitled to credit the tax paid on the goods (works, services) used in the course of making the transaction. insert this below

Chapter 15. Transactions Taxed at Zero Rate

3.102 Taxation of the Export of Goods

The export of goods is taxed at a zero rate. The customs entry made in accordance with the customs legislation, which indicates that the goods cleared the territory of Georgia, is considered to be a document evidencing the export of goods.

3.103 Taxation of International Transportation

Services related to international air transportation of passengers and goods as well as aviation fuel, lubricants and other auxiliary substances supplied on board for international flights are taxed at a zero rate. Transport by means other than air is exempt from VAT.

“International transport” is the transport of goods between Georgia and any other state or between two other states wholly outside of Georgia. Refer to article 101(ee) for rules pertaining to international transport other than by air. For exported goods international transportation commences from the Georgian customs clearance point, and for imported goods international transport ceases at the customs clearance point.

The place of supply of international transport is the state in which the transportation takes place to the extent that it takes place in that state.

To the extent that the air transport takes place outside of Georgia it is outside of the scope of Georgia’s VAT. (The air transport of goods between two places both outside of Georgia is outside the scope of Georgia’s VAT.)

Normally the air transport of export goods to the point of customs clearance will be included in the price of the goods which, because the goods are for export, will be zero-rated. However, if there is a separate distinct charge for the service that relates wholly to the air transport of the goods in Georgia this will be subject to VAT at the normal rate. For imported goods the cost of air transport will be added to or included in the customs’ value of the goods.

Incidental services, i.e. casual and non-essential services, such as arranging entertainment for the crew or hotel accommodation for the crew would not be covered by this article. However, in addition to normal air transportation costs there are ‘ancillary freight transport services. “Ancillary freight transport services” include loading, unloading, handling and similar activities. Included are the services of reloading, stowing, opening for inspection, cargo security services, preparing or amending bills of lading, airway bills and certificates of shipment, packing necessary for transportation and storage. Ancillary air transport services in connection with international freight transport are treated as supplied where the services are physically performed. The VAT liability of ancillary freight transport services is the liability that Georgia would apply to the particular service.

3.104 Taxation of Gold Transferred to the National Bank of Georgia

Refer to the Tax Code.

Chapter 16. Time and Place of Taxable Transaction and Special Rules

3.105 Time of Taxable Transaction

1. Refer to Tax Code.

Example

A registered taxpayer makes a taxable transaction on May 10, 2000 but is not paid for the goods until September 30, 2000. The transaction is not required to be included in his tax return for the month of May 2000, nor for June or July 2000. It does have to be included in his tax return for August 2000 because 90 days after May 10 is August 8. Therefore, the tax point is August 8, 2000 even though he has not been paid.

2. When payments are made for a taxable transaction in two or more installments each payment is treated as a separate transaction. The tax point is determined for each payment based on the 90-day rule described above. The balance of the unpaid tax, if any, becomes payable 90 days after the taxable transaction irrespective of any installment that may be outstanding.
3. For ongoing services the tax point is at the time of the issue of an invoice, or payment made, for any part of the service. For ongoing services for which no invoice is issued or payment made the tax point will normally be 90 days after the end of each month for which the ongoing service is provided or the date of any payments for that service whichever is the sooner. However if any payments made are less than what would otherwise be payable in that month the balance will be taxable 90 days after the transaction took place.
4. Refer to Tax Code.

Per article 96(2) the object of VAT is the taxable transaction and taxable import, even if such transaction or import is carried out gratuitously. Refer to article 101 for exceptions to this rule. Thus the use of goods, works or services for non-economic reasons will not release a person from VAT.

Example 1

A physical person entrepreneur who sells television sets purchased 10 televisions in January 2000 on which he received VAT credit. In March he put one of the ten televisions in his child's room. The above transaction is a non-economic activity and the taxable transaction is deemed to be occur in March.

Example 2

A taxpayer supplies goods to his employees without charge. Such supply will be a taxable transaction. The time the goods are supplied will be considered the time the transaction was carried out.

5. Before a cancellation of registration can become effective VAT must be accounted for on all goods on hand for which an input tax credit has been allowed.

4.106 Place of Supply of Goods

1. Goods are normally supplied where they are physically located when allocated to a specific customer order. This will apply if the supply of the goods involves the cost of transportation. If however the cost of transportation is the responsibility of the recipient the place of supply will be the place to where the goods are transferred.
2. Although the export of thermal energy, gas and or water is considered a supply that takes place in Georgia, nevertheless it is an export and as such is subject to VAT at the zero rate.

3.107 Place where Works are Fulfilled or Services are Rendered

1. Refer to the Tax Code for rules regarding the place of fulfillment of works or the rendering of services. Contracts between persons for the fulfillment of works and/or the rendering of services, deeds signed by the seller and the buyer and other instruments are considered to be the documents evidencing the place of fulfillment of works and rendering of services.
 - a. Works and services in respect of immovable property include construction, erection, repair, restoration, landscaping and other similar services.

The place of supply is the place where immovable property is located if the works or services are directly connected with that property;

Example

A Georgian person who owns a building in Tbilisi has hired a Turkish person to prepare a feasibility study for an overhaul of the building. Since such services are connected with the immovable property located in Georgia the services are considered to take place in Georgia.

- b. Where movable property is concerned the place where the works are actually carried out is the place of supply.

Example

Georgian legal person IRMA entered into an agreement with a Russian legal person for repair work of a broken machine. The above activity will be deemed as a work carried out in Russia if the machine is taken to Russia for repair. If

the Russian enterprise comes to Georgia to fix the machine the above service will be deemed as the service rendered in Georgia and will be subject to reverse charge.

- c. Refer to Tax Code.
- d. If the services are connected with a transportation the place of supply is where the transportation takes place.

Example

A person is engaged in the sale of travel tickets for international transportation outside the borders of Georgia. The services in connection with such sale of tickets in Georgia are considered as services of an international transportation carried out in Georgia and are taxed at a zero rate, while the same services rendered on a foreign territory are considered as the services rendered abroad and are not treated as a taxable transaction. The VAT liability of transactions connected with the performance of works or rendering of services by a Georgian registered taxpayer in connection with international transport outside the borders of the territory of Georgia are considered as carried out on the territory of Georgia.

- e. Engineering and consulting services include but are not limited to:
 - preparation of feasibility studies;
 - preparation for the production and sale of goods, works or services;
 - preparation of construction and operation required for to produce goods, works or services; and
 - preparation of designs.

Data processing services include but are not limited to the collection and systemization of information files.

- 2. Where the works fulfilled and/or services rendered in subarticle 1(a-e) are provided in more than one the place of supply is determined according to the first applicable item in subarticle 1.

3.108 Reverse Charge

1. If a nonresident person, who is not registered for VAT in Georgia, renders services or fulfills works on the territory of Georgia for a tax agent indicated in part 2 of this article, fulfillment of works or rendering of services is taxed according to this Article.
 - a. Services brought in from foreign suppliers by Georgian customers are normally subject to the “reverse charge” or “tax shift” mechanism. The customer converts the purchase invoice into GEL (if not already in GEL), adds VAT and pays it as output tax on the appropriate return. He then claims a credit for it as input tax on the same return subject to the normal input tax credit rules.

The reverse charge applies to all taxable services where the place of supply is Georgia. It does not apply to any zero-rated or exempt services.

Example 1

A Georgian VAT registered enterprise receives services relating to the audit of its accounts by a French accountant. The French accountant would not account for VAT in France, nor would he charge VAT to the Georgian enterprise. The Georgian enterprise would account for the VAT under the reverse charge mechanism by adding the amount of VAT and paying it as an output tax to the appropriate return. After declaring taxes payable by a non-resident (the French accountant) the tax agent (Georgian enterprise) must either pay this amount or deduct it from its VAT credit.

Example 2

An Australian enterprise and a Georgian enterprise formed a joint venture to carry out geological surveys. Instead of directly investing money in the joint venture the enterprise has brought in surveying and other equipment from Australia. It has constructively invested in the joint venture and has paid for this equipment out of part of the investment that it would have otherwise made in the joint venture.

The equipment that has been brought in must be operated by specialists which neither the Australian nor the Georgian enterprise have. As a result the Australian enterprise has arranged for another Australian enterprise (Australian enterprise #2) to operate the equipment. This will be expense paid in Australia by the first Australian enterprise from a further part of the investment it would otherwise have made in the joint venture.

Australian enterprise #2 does not have a permanent establishment in Georgia and is not covered by article 17. Therefore it is not required to register for Value Added Tax.

Assuming that the turnover of the joint venture exceeds the VAT turnover threshold and its operations are chargeable with VAT the joint venture will be registered for Value Added Tax. The supply of the service by Australian

enterprise #2 is a taxable supply and as such VAT has to be charged on that supply.

The joint venture is the tax agent and has to withhold the appropriate amount of VAT from the amount that is payable to Australian enterprise #2 and account for that to the Tax Agency (Article 108 Reverse Charge.) The amount of tax that has to be assessed is calculated by reference to the price that the first Australian enterprise paid to Australian enterprise #2 in Australia. That it was paid in Australia, by the first Australian enterprise, is irrelevant. In fact it has been paid for by the joint venture from money constructively invested in the joint venture by the Australian enterprise.

Provided the equipment and its operation is for the joint venture then it is the responsibility of the joint venture as the registered taxpayer to account for the VAT due under the Reverse Charge rule. If the Australian enterprise operates the equipment and uses the specialists for purposes other than for the joint venture it is operating independently from the joint venture and has to be considered as a separate enterprise.

- b. The following works performed and services rendered on the territory of Georgia by non-residents not having a permanent establishment and not registered as VAT payers shall be subject to VAT under the reverse charge.
 - the leasing of movable and immovable property;
 - the works and services directly connected with immovable and movable property located in Georgia;
 - the transport and forwarding services which are rendered on the territory of Georgia and which do not represent international transportation and shipments;
 - services in the field of education, physical fitness and sports; culture, art, advertising services;
 - services connected with data processing and information provision;
 - services connected with the transfer or assignment of rights to patents, licenses, trademarks, copyrights, as well as the rendering of such services for which a non-resident receives royalty; and
 - consulting, legal, accounting, engineering and other similar services, as well as such works and services which are considered to be fulfilled or rendered by a non-resident on the territory of Georgia.

The reverse charge is also applicable to the works performed and services rendered by the non-residents who are treated as performers of economic activity in Georgia without a permanent establishment in accordance with Article 17 of the Tax Code and international treaties to which Georgia is a party.

2. For the purposes of the reverse charge any person registered for VAT or any resident legal person is deemed a tax agent. A resident physical person who is not registered for VAT is not a tax agent and the reverse charge rule does not apply.

3. In case where part 1 of this Article applies, a tax agent charges VAT on the sum payable to the nonresident. The VAT amount is determined by applying the tax rate under Article 112(1).
4. If a tax agent is registered for VAT, the assessed VAT is payable upon submission of a VAT return for the month in which works were fulfilled or services rendered. The document confirming the payment of the assessed VAT is considered to be a tax invoice, which gives a tax agent the right to claim input tax credit in compliance with article 114.

Example

Georgian enterprise SIO, a VAT payer, purchased 20 pianos. The pianos were later damaged by water. SIO paid a fee to Austrian enterprise VIENNA to send experts to Georgia to renovate the damaged pianos. SIO sent the Tax Agency document confirming payment and requested that the reverse charge VAT be deducted from its tax credit. The Tax Agency shall deem this document as payment. The date of the document will be deemed the date of the payment. If the document is submitted timely penalties for late payment will not be assessed. SIO will also received credit for the amount deducted under article 108(4).

5. If a tax agent is not registered for VAT he/she is required to pay the assessed VAT in compliance with the procedures defined by the Tax Revenue Ministry of Georgia within 15 days of the date when the works fulfilled or services rendered. In addition to paying the VAT assessed under the reverse charge rule a non registered tax agent is to submit a report of the VAT assessed.
6. The reverse charge rule defined by this article is also applied to the transactions carried out by an agent of the principal. In cases where the principal is not registered for VAT, a supply of goods, fulfillment of work or rendering of services is considered to be carried by an agent who will be the tax agent for the purposes of the reverse charge rule.

3.109 Time of Import

Refer to Tax Code.

3.110 Mixed Transactions

1. A supply of goods, fulfillment of works, or rendering of services which is incidental to a main supply of goods, works or services, is treated as a part of the latter and determined according to articles 105 and 107.
2. Refer to Tax Code.
3. A taxable transaction involving independent elements, one or more of which if separately supplied, rendered, or fulfilled would be exempt from tax, is treated as separate transactions. An exempt transaction with independent elements, one or more of which is separately supplied, rendered, or fulfilled would be taxable for VAT, is treated as separate transactions.

When an enterprise supplies a mixture of goods and/or services it must determine whether each element of the sale should be treated as separate transactions for VAT purposes (a mixed supply) or whether only one supply is being made, albeit made up of two or more elements (a composite supply).

Example 1

A wholesaler sells goods regularly to a supermarket. The latest invoice is for a whole variety of taxable goods, plus baby food and infant hygiene products that are exempt. The latter items will be treated as separate transactions and will not be taxed. Where it is not possible to split the prices of a mixed supply the total must be split on a pro rata basis using a method accepted as fair and reasonable to the tax authority. However elements that are part of another product are not considered to be separate transactions and make up a composite supply.

Example 2

A minor part of a taxable publication is subject to VAT. However, if a minor part of a taxable publication is published as part of educational materials approved by the Ministry of education the part is not considered to be an independent element and is not subject to VAT.

Example 3

A post office sells envelopes with a stamp printed on them. In this case the stamp is treated as an independent element and is not taken with other goods. Accordingly, the nominal value of the stamp is considered to be exempt from tax. The taxable amount will be the total selling price of the envelope including the stamp less the nominal value of the stamp.

3.111 Transaction by Agent

1. Refer to Tax Code.

For VAT purposes an agent:

- enters into a contractual agreement, either written or oral, with his principal to arrange supplies of goods and/or services on his principal's behalf;
- does not take title to the goods supplied by the principal;
- does not use services supplied by the principal; and
- only receives commission for his services to the principal.

Enterprises such as employment agencies and distributors usually act as principals rather than agents, whereas a lawyer can act as an agent in arranging legal matters for a client.

Where an agent acts in the name of his principal the sales invoice should be completed showing the principal as the supplier of the goods or services to the ultimate customer.

Example

An auctioneer sells at auction goods of another person (his principal). Under an agreement between the principal and the auctioneer, the goods are the principal's property until the moment of their sale. The auctioneer acts as the principal's agent in the course of the goods sale. If the principal is a VAT payer, sale of the goods by the auctioneer is considered to be a taxable transaction carried out by the principal.

When an agent acts in his own name according to an agreement, conducts negotiations with the third person, and issues and receives the invoices in his name the goods will be regarded as purchased and supplied by the agent. The agent has to account for the VAT on the goods supplied and has the right to input tax credit for the goods and/or services used for this activity.

2. If the agent is registered as a VAT taxpayer he must issue a VAT invoice to the principal on the service rendered if the principal is registered as a VAT taxpayer and pays VAT.
3. If a person is non-resident and is not registered for VAT and his goods are sold in Georgia by an agent (including on the basis of consignment), the sale of the goods is considered as a transaction carried out by the agent.

Chapter 17. VAT Calculation and Payment Procedures

3.112 Rates of VAT

1. Refer to the Tax Code for the VAT rate.
2. The taxable turnover is the total value of taxable transactions during the reporting period. (Refer to article 105 for rules regarding the time of taxable supply.)

3.113 VAT on Taxable Turnover Payable to the Budget

1. The VAT payable to the budget in each return period is the total of the tax charged on supplies made during the period (the output tax) determined under article 112(1) less any tax paid on supplies received during that period that is eligible for credit (the input tax) determined under article 114. Article 3.105 provides that the time of supply can occur 90 days after the supply of goods, fulfillment of works or performance of services. The total VAT that is creditable is the total VAT paid to a supplier or paid at Customs according to a tax invoice or customs declaration.

When an enterprise is first registered for VAT there is an entitlement to a credit of the input tax that has been paid, prior to registration, on goods in hand that will be used for the economic activity of the enterprise. To be able to claim such an input tax credit the newly registered taxpayer must carry out an inventory as stipulated in article 77(5)(a) and provide evidence that the VAT has been paid. The amount of VAT included in the value of goods in stock, based on tax invoices, are to be recorded separately in the accounts and shown as such on the return for the first accounting month according to the normal procedures.

2. Where an adjustment is necessary under article 99 any amount payable subarticle 1 above is to be amended accordingly.

3.114 VAT Creditable in the Determination of Payments to the Budget

1. VAT that a registered enterprise pays upon its purchases of goods and services either for re-sale or use in its economic activity is known as its input tax. This input tax may be credited provided the goods or services concerned are used or are to be used in the making of taxable supplies.
2. Refer to Tax Code.
3. Refer to Tax Code.
4. Where a VAT taxpayer has taxable transactions and VAT exempt transactions in accordance with this Code, the VAT credit is determined pro rata to the amount of goods, works or services used in taxable transactions. If it is not possible to make such differentiation the VAT credit is determined on the basis of the ratio of the taxable turnover to the total amount of the turnover in the previous year, which is determined in the declaration for December at the end of tax year. This subarticle applies after the requirements of the part 2 of this article are met.

Example

The major activity of the CCC bank is providing financial services that are exempt from tax. At the same time CCC bank carries out taxable transactions, including renting safe boxes and providing consultation services. CCC bank determines the ratio of taxable turnover according in the previous year to be 5 percent. Accordingly, CCC bank has right on percent of VAT credit paid to a supplier on sale carried out in each accounting month of current year to be used in economic activity. At the end of the year it turned out that the ratio of taxable turnover is 8 percent. Accordingly, an additional credit amount of 3 percent (8 percent less 5 percent) will be reflected in CCC bank's December declaration.

5. Refer to Tax Code.

3.115 Tax Invoice

1. Refer to the Tax Code for rules regarding the issuance of tax invoices. A purchaser and a seller are to submit tax invoices to the tax agencies on a monthly basis no later than 15th of following month. A person who is not registered for VAT does not have the right to issue a tax invoice.
2. The tax invoice is developed by the Tax Revenue Ministry. Refer to the Tax Code for information that must be included on the tax invoice.
3. Where an invoice is issued in accordance with article 68 for each delivery, all deliveries made during the course of a day to the same purchaser may be included on one tax invoice provided that tax invoice is issued to the purchaser not later than on the second day from the delivery of goods, works or services.

4. Where a tax invoice that should have been returned to the tax authority for cancellation has not been returned the registered enterprise must account for the VAT erroneously entered on that tax invoice as well as the tax on any replacement tax invoice.
5. Refer to Tax Code. The Tax Revenue Ministry has established a special VAT invoice for oil distillates.
6. Refer to Tax Code.

Chapter 18. Administrative and Concluding Provisions

3.116 Filing of Returns and Payment of VAT

1. A VAT payer is required:
 - a. to file a VAT return with a tax agency at the place of registration for each reporting period not later than the 15th of the month following the reporting period. A return has to be filed by each and every registered VAT taxpayer regardless of whether the taxpayer had any taxable turnover during the period of the return.
 - b. to pay the VAT to the budget for every reporting period by the deadline for filing the return.
2. Deleted in Tax Code.
3. Refer to Tax Code.
4. Refer to Tax Code.

3.117 VAT Reporting Period

Refer to Tax Code.

3.118 Relations to the Budget in Cases Where the Sum of VAT to Be Credited Exceeds the Amount of Tax Charged for the Accounting Period

1. Refer to Tax Code.
2. Taxpayers who are due a repayment of VAT by way of an input tax credit may apply to the tax authority for a repayment of the credit due. Such repayment must be paid within 15 days of the application being received by the tax authority or, by agreement, may be carried forward as a credit to the next period return.
3. When an amount refunded by the tax agency is incorrect the tax agency may demand the return of the incorrect amount according to VAT payment procedures.

3.119 Refund of VAT on Goods Purchased through Grants

1. Refer to Tax Code.

The recipient of a grant may only be a non-entrepreneur person who has been designated as a grantee by the Ministry of Finance.

2. Refer to Tax Code.

3.120 Responsibility of Taxpayers and Control by Tax Organ

1. A VAT taxpayer is required to:

- be registered for VAT with the Regional Tax Inspectorate;
- calculate and collect VAT on the supplies that it makes;
- issue tax invoices to purchasers who it supplies;
- ensure the consistency of every accounting entry within the established norms, which must reflect accurately the volume of the taxable turnover, the zero-rated turnover and the VAT exempt turnover, as well as any VAT amount that is subject to credit;
- maintain all accounting records, invoices issued, tax invoices received from suppliers and documents of payment;
- submit VAT declaration on a monthly basis and pay any VAT for the established amount;
- upon request of tax inspectors submit all accounting books, accounting records, tax invoices and the like for the audit;
- in the event of cessation of VAT taxable transactions require the cancellation of VAT registration and return the VAT registration certificate together with any invoices that are not used; and
- on a monthly basis submit to the tax agency, along with their declaration, the third copy (used for credit) and the fourth copy (issued by a taxpayer) of each taxable invoice, and four copies of any invoices that were completed incorrectly.

A VAT registered taxpayer must:

- keep such books and records as will enable the tax authority to verify any transactions affecting how much VAT is payable by him or refundable to him. All activities that generate a taxable, zero rated or exempt income must be recorded so that the tax authority can verify the output tax and any partial exemption calculations, and determine the correct amount of input tax creditable in any particular period.
- ensure the safekeeping of all books and records, tax invoices (including those issued to buyer and received from suppliers and the customs bodies and other documents) and their presentation to an authorized person of the tax authority when required.

Responsibility for the incorrect calculation and timely payment to the budget of VAT and the presentation of a return to tax agencies by the prescribed deadline rests on the taxpayer and/or their responsible persons in accordance with the Tax Code. In the case where the collection of VAT is in the competence of customs agencies of Georgia the customs legislation of Georgia will apply.

2. Refer to Tax Code.

3.121 Financial Sanctions Applied In The Event Of Non-Performance of Requirements Provided For In This Part

1. Refer to Tax Code.
2. Refer to Tax Code.

END OF VAT INSTRUCTIONS

PART IX. SOCIAL TAX

Chapter 29. Social Tax

9.184 Social Tax

The social tax is a tax necessary for the state consolidated funds of social welfare and employment to carry out their obligations. The social tax is paid by taxpayers on the amounts of wages and payments equalized to wages, and also on income received by physical persons from economic activity, as established by Part IX of Tax Code and as explained in these instructions.

9.185 Taxpayers

Payers of Social Tax are:

- a. Physical person entrepreneurs and legal persons who make payments of wages to physical persons working as employees in Georgia. Refer to instruction article 1.9(1) for factors to apply when determining whether an employment relationship exists. Also refer to applicable definitions contained in article 29.
- 1) The terms “physical person” and “legal person” have the meanings as provided in the Civil Code of Georgia. A physical person is a human individual. A legal person is defined in article 24, Part 1 of the Civil Code of Georgia, as follows.

Civil Code, Article 24. Concept. Types

A legal person is an organizational formation founded for achieving a definite objective that has own property and is independently liable for its obligations with its property, may in its own name acquire rights and duties, and appear as a plaintiff or defendant in court.

For further definition and clarification of the meanings of physical persons and legal persons refer to the Civil Code should be consulted.

- 2) A “physical person entrepreneur” is a physical person who is considered to be an entrepreneur in accordance with article 26 of the Tax Code if he is engaged in entrepreneurial activity independently and at his own risk without establishing a legal person. A physical person entrepreneur is a self-employed person. Performance by a physical person of entrepreneurial activity in violation of established procedure for registration and receipt of license, certificate, or any other similar document does not create a basis for non-recognition of the physical person as an entrepreneur for the purpose of taxation.
- 3) The term “employment” is explained in article 9 of the Tax Code, which states that a physical person engaged in employment is called an “employee”. A person who pays for the services of a physical person as an employee is called

an “employer”, and such a payment is called “wages”. An employer is required to pay social tax on wage payments.

- b. Physical persons entrepreneurs and legal persons who in the course of economic activity make payments to physical persons who render services in Georgia on the basis of contracts or without a contract.
 - 1) Article 7(1) of the Tax Code defines “economic activity” as any activity aimed at the receiving profits, income, or compensation, regardless of the results of such activity, unless otherwise stipulated by article 7.
 - 2) Economic activity comprises both entrepreneurial and non-entrepreneurial activity. An activity is an economic activity if the taxpayer’s intentions are to achieve profits, income, or compensation. A person who conducts an activity with the intent to earn profit, income, or compensation is involved in economic activity even if it fails to earn profits, income, or compensation.
- c. Physical persons receiving remuneration according to items “a” or “b” of this article.
- d. Physical persons entrepreneurs and persons equaled to them according to the Tax Code that carry out entrepreneurial activity in Georgia.
 - 1) Article 8(1) of the Tax Code as an activity determined under Article 1 of Law of Georgia on Entrepreneurs; namely, such as an economic activity that is carried out in the form of commercial transactions or other economic operations. Article 1 of the Law of Georgia on Entrepreneurs provides that entrepreneurial activity is a repeated activity carried out independently and in an organized manner to gain profit. For further clarification see Article 1 of the Law of Georgia on Entrepreneurs.
- e. Physical persons who perform non-entrepreneurial activity independently in Georgia in consistence with article 1.2 of Law of Georgia on Entrepreneurs. Article 1(2) of Law of Georgia On Entrepreneurs provides that creative, scientific, architectural, auditory, agricultural, timber-industry activity, medical, attorney and notary practice of individuals are not considered entrepreneurial activities.

Such persons are subject to required to obtain a Taxpayer Identification Number (TIN) within the time period specified in article 219(3).
- f. Branches and other structural units specified in article 12(1)(c) are independent payers of social taxes.

9.186 Object of Taxation

1. In cases of payments to physical persons for wages as described in instruction articles 9.185(1)(a), and for services rendered as described in 9.185(1)(b) of these instructions, the amount that is subject to social taxes is equal to the amount of income received in the form of wages as defined in article 38.
 - a. Payments and incomes received from employment by a physical person, including a pension and other income received from a previous place of employment and income from a future place of employment, are included in income for social tax purposes.
 - b. For purposes of (1)(a) of this article, the amount to be included in income that is subject to social tax is the benefit received by the employee net of any amount paid by the employee for the benefit. See instruction article 2.38(2) for examples of benefits that are also subject to income as well as social tax.
2. The object of taxation for physical persons who receive payments for wages or rendering services as described in instruction article 9.185(1)(a) and b) is the same as that provided for the payment of wages or other remuneration pursuant to instruction part 1 of this article.
3. For taxpayers described in instruction article 9.185(1)(d) the amount that is subject to social tax is the taxable income derived from entrepreneurial activities as determined according to the income tax rules under the Tax Code.
4. For taxpayers described in instruction article 9.185(1)(e) the amount that is subject to social tax is the taxable income derived from non-entrepreneurial activities as determined according to the income tax rules under the Tax Code.

9.187 Tax Exemptions

The following income is not subject to social tax.

- a. Amounts paid to persons confined to correctional institutions under court order;
- b. Payment for temporary inability to work, paid out of the resources of the fund of state social insurance;
- c. Amounts paid out of the resources of organizations which were received as grants;
- d. Income of individuals working at diplomatic and consular establishments as employees who are not citizens of Georgia;
- e. Income received by a person who is a non-resident of Georgia and that resides on the territory of Georgia for less than 90 days during the tax year if this income is

paid out by an employer who is a non-resident of Georgia or on his/her behalf and not by the permanent establishment of a non-resident.

- 1) The person receiving the income must be a non-resident of Georgia. Article 25 of the Tax Code states that a non-resident physical person is one who is not a resident. Physical persons are recognized as residents if they were actually located on the territory of Georgia for more than 182 days in any 12-month period ending in a tax year, or were in the Georgian State service abroad during the tax year. Refer to article 25 and the instructions thereunder for rules and examples pertaining to residency.
- 2) The non-resident person receiving the income must reside on the territory of Georgia for less than 90 days during the tax year. Business trips, holidays and other days outside Georgia are not counted as days in Georgia.
- 3) The employer must be a non-resident of Georgia, and must not have a permanent establishment in Georgia. Article 17 of the Tax code states that a permanent establishment of a foreign physical person or enterprise is one that carries out, in full or in part, an economic activity. Refer to article 17 and the instructions thereunder for rules and examples pertaining to permanent establishment.

Example 1

Michael, a non-resident of Georgia, worked for NONREZ, a non-resident employer, from November 1, 1998 to April 15, 1999, when he left Georgia to return to his home country. NONREZ paid Michael wages of 500 GEL per month. NONREZ did not have a permanent establishment in Georgia.

The income NONREZ paid Michael in 1998 is exempt from Georgia social tax because:

Michael is a non-resident person;

Michael was in Georgia for less than 90 days during 1998; and the wages were paid to Michael by a non-resident who did not have a permanent establishment in Georgia.

The income NONREZ paid Michael in 1999 is subject to Georgia social tax because Michael, although still a non-resident, was in Georgia for more than 90 days during 1999

Example 2

Assume the same facts as Example 1, but that Michael was paid by the permanent establishment of NONREZ. Michael's wages in both 1998 and 1999 will be subject to social tax.

- 4) Income of foreign citizens hired for oil and gas work according to the Law on Oil and Gas is exempt from social tax.

9.188 Rates of Tax

1. The rates of social tax and employment tax are as follows.

- a. For persons described in article 185(1)(a), (b), (d) and (e) tax rate on the taxable amount that is payable to the Social Welfare Consolidated State Fund is 27 percent, but not less than 16 GEL per person per month. The 16 GEL minimum applies to each month in which:

1) a physical person performs services for a physical person entrepreneur or legal person described in articles 185 (a) or (b); or

2) a physical person described in articles 185 (d) or (e) performs services

regardless of the number of days services were performed.

Example 1

*On November 28, 1999 Dato began work for Georgian legal person YOU under an employment contract. Dato's monthly wages were 80 GEL per month. YOU paid Dato 8 GEL ($[80 / 20 \text{ work days}] * 2 \text{ days}$) in November. In November YOU must pay social taxes on the wages paid to Dato as follows.*

<i>Wages paid</i>	<i>8</i>
<i>Social tax rate</i>	<i><u>27 %</u></i>
<i>Social tax liability</i>	<i>2.16 GEL</i>

Although this calculation determines a social tax liability of 2.16, article 188(a) sets a minimum payment of 16 GEL per person per month regardless of the number of days worked. Therefore, YOU must pay 16 GEL in social taxes on the wages it paid to Dato in November.

Example 2

Assume the same facts as in Example 1, but that Dato performs cleaning services for YOU under a service contract for the period November 29 through December 8, 1999 (a total of 10 workdays). Dato is paid 100 GEL for the services he performs.

In November YOU must pay social taxes on the portion of income attributable to the 2 days Dato performed services in November. YOU's November social tax liability is computed as follows.

<i>Income paid under the contract</i>	<i>100</i>
<i>Income attributable to days services were performed in November ($100 * [2 / 10 \text{ days}]$)</i>	<i>20</i>
<i>Social tax rate</i>	<i><u>* 27 %</u></i>
<i>Social tax liability</i>	<i>5.40 GEL</i>

Although this calculation determines a social tax liability of 5.40 GEL, article 188(a) sets a minimum payment of 16 GEL per person per month. Therefore, YOU must pay 16 GEL in social taxes on the income earned by Dato in November.

For persons described in article 185(1)(a), (b), (d) and (e) the tax rate on the taxable amount that is payable to the State Employment Fund is 1 percent.

Example 1

Tolia, a Georgian employer, paid each of its 5 Georgian employees wages in the amount of 2000 GEL during July 2000. Tolia must pay social and Employment Fund taxes as follows.

Wages paid (2000 * 5)	10000
Social tax rate	<u>27 %</u>
Social tax liability	2700 GEL

Wages paid	10000
Employment Fund tax rate	<u>1 %</u>
Employment Fund tax liability	100 GEL

*The social tax is payable to the Social Welfare Consolidated State Fund.
The Employment Fund tax is payable to the State Employment Fund.*

Example 2

RRR, a Georgian employer, paid each of its 3 Georgian employees 40 GEL in July 2000. RRR must pay social and Employment Fund taxes as follows.

Wages paid (120 * 3)	120
Social tax rate	<u>27 %</u>
Social tax liability	32.40 GEL

*Although this calculation determines a social tax liability of 34.40, article 188(a) sets a minimum payment of 16 GEL per person per month. Therefore, RRR must pay 48 (16 GEL * 3 persons) in social tax on the wages it paid to its 3 employees in July.*

Wages paid	120
Employment Fund tax rate	<u>1 %</u>
Employment Fund tax liability	1.20 GEL

There is no minimum employment tax amount.

*The social tax is payable to the Social Welfare Consolidated State Fund.
The Employment Fund tax is payable to the State Employment Fund.*

- b. For physical persons described in article 185(1)(c) (physical persons receiving remuneration from persons described in article 185(1)(a) and (b)), the tax

payable to the Social Welfare Consolidated State Fund is 1 percent of the taxable amount. Such persons are not subject to the 1 percent tax payable to the State Employment Fund.

Example

Linda was an employee of RTY, a Georgian employer. For the month of August 2000 RTY paid Linda wages of 500 GEL. Linda must pay social taxes as follows on the wages she received in August.

<i>Wages received</i>	<i>500</i>
<i>Social tax rate</i>	<i><u>1 %</u></i>
<i>Social tax liability</i>	<i>5 GEL</i>

This amount (5 GEL) is to be withheld at the source of payment and paid in to the Social Welfare Consolidated State Fund by the employer. Linda is not subject to the 1 percent tax payable to the State Employment Fund.

2. For public organizations of disabled persons, and for the remuneration of disabled persons and pensioners working at such organizations and their enterprises, if more than 70 percent of employees are disabled persons and pensioners, the rate of tax to the Social Welfare Consolidated State Fund as indicated in article 188(1)(a) is reduced from 27 percent to 10 percent. The 16 GEL per person per month minimum social tax required in article 188(1)(a) continues to apply. The 1 percent tax payable to the State Employment Fund also applies.

Example

SAN is a public organization of disabled persons in which more than 70 percent of the employees are disabled persons and pensioners. In July 2000 SAN paid wages of 300 GEL to each of its 6 employees.

SAN will compute its July 2000 social tax liability as follows.

<i>Wages paid (300 * 6)</i>	<i>1800</i>
<i>Social tax rate</i>	<i><u>10 %</u></i>
<i>Social tax liability</i>	<i>180 GEL</i>

SAN will compute its July 2000 employment tax liability as follows.

<i>Wages paid</i>	<i>1800</i>
<i>Employment Fund tax rate</i>	<i><u>1 %</u></i>
<i>Employment Fund tax liability</i>	<i>18 GEL</i>

SAN employees will compute their social tax liability as follows.

<i>Wages received</i>	<i>300</i>
<i>Social tax rate</i>	<i><u>1 %</u></i>
<i>Social tax liability</i>	<i>3 GEL</i>

The 3 GEL will be withheld at the source of payment and paid in to the Social Welfare Consolidated State Fund by the employer.

9.189 Procedure for Determination and Payment of Tax

1. In cases described in instruction article 9.185(1)(a) and (b) social tax is withheld from the wages or other remuneration paid to the employee. If the wages are paid through a bank, the employer must provide payment instructions for the bank to pay the tax. If the taxpayer fails to present instructions to the bank for the payment of tax, the remuneration amount will not be released.
2. Social tax due from the employee is withheld by the employer when wages are paid and is remitted according to the procedure described in instruction article 9.189(1) above.
3. Physical persons described in instruction article 9.185(1)(d) and (e) must pay social tax together with their income tax. The requirements for the current payments of social tax are determined according to article 89. The social tax return is submitted with income tax return.

Example

Giorgi, a physical person entrepreneur, paid 240 GEL in social tax for the year 1999. In accord with Article 89 of the Tax Code, for the year 2000, he should make current social tax payments as follows.

<i>Before May 15, 2000</i>	<i>72 (30% * 240 GEL)</i>
<i>Before August 15, 2000</i>	<i>72 (30% * 240 GEL)</i>
<i>Before November 15, 2000</i>	<i>96 (40% * 240 GEL)</i>
<i>Total current payments</i>	<i>240 GEL (100% * 240 GEL)</i>

When Giorgi files his annual income tax return for the year 2000 in April 2001 he must also file an annual social tax return.

4. Payers of social tax, persons described in instruction article 9.185(1)(a) and b) will submit a social tax calculation to the Tax Department by the 15th day of the following reporting month. The calculation will be submitted on a cumulative basis starting from the beginning of the year.

Fines and penalties provided in the Tax Code apply to persons who fail to timely submit social tax payments or social tax returns. Refer to articles 252 and 253 for additional information on these fines and penalties.

END OF SOCIAL TAX INSTRUCTIONS

PART XIV. PROCEDURE FOR THE ADMINISTRATION OF TAXES

Instructions for selected articles of the Tax Code are provided below.

Chapter 36. General Provisions**14.219 Taxpayer Identification Number**

1. Refer to Tax Code.
2. Refer to Tax Code.
3. Legal persons, as well as physical persons described in article 26 of the Tax Code and in article 1.2 of the Law of Georgia on Entrepreneurs are required to apply to a tax body to obtain a taxpayer identification number (TIN) within 10 days from registration or the initiation of entrepreneurial activity.

This registration requirement applies to foreign legal entities that have a permanent establishment in Georgia per article 17, but does not apply to foreign legal entities that do not maintain a permanent establishment in Georgia.

The cancellation of registration as a VAT taxpayer does not result in the withdrawal of the TIN.

END OF TAX ADMINISTRATION INSTRUCTIONS